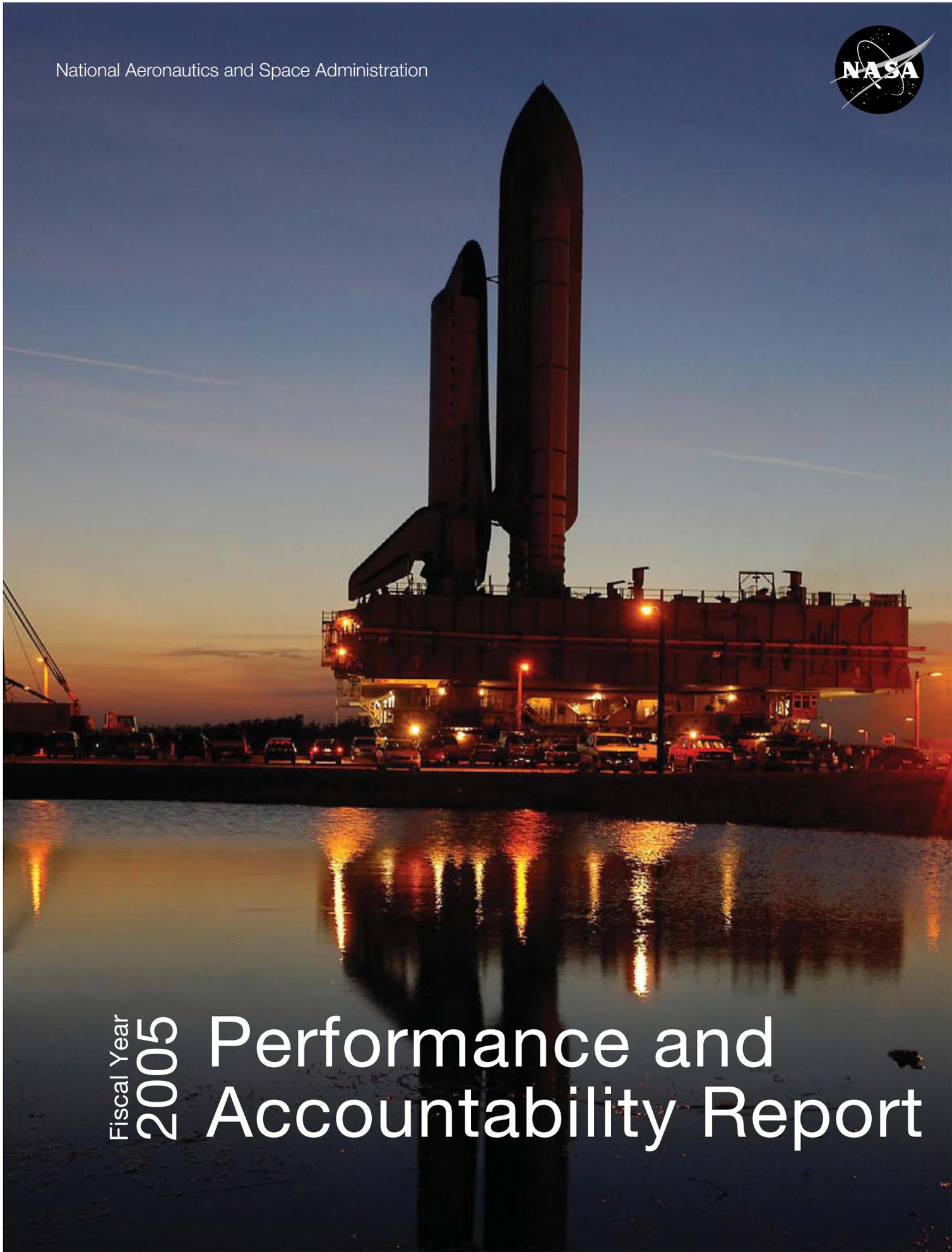


National Aeronautics and Space Administration



Fiscal Year
2005

Performance and Accountability Report



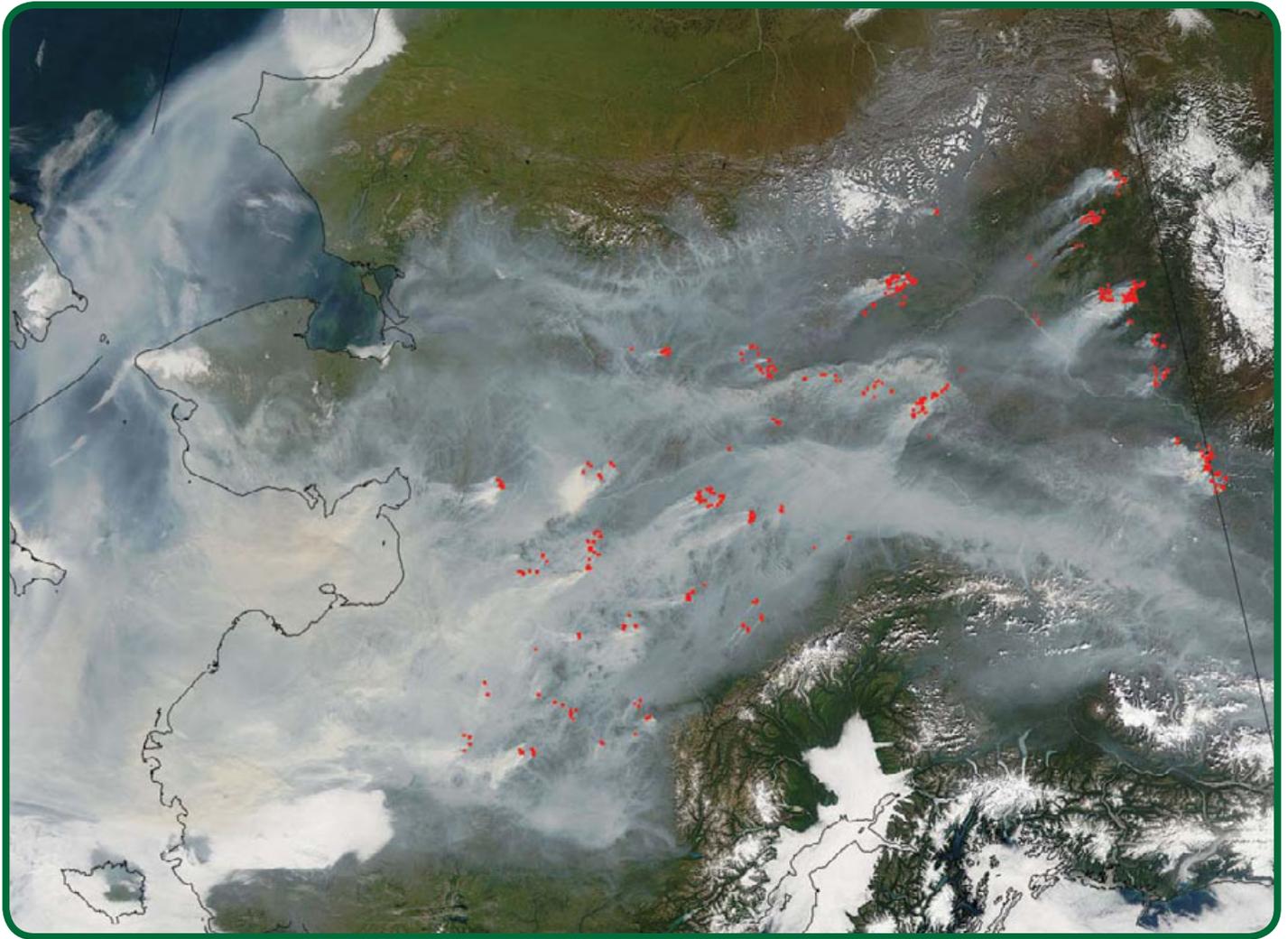
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Part 3: Financials



Previous page: NASA's ER-2 takes off from the airport in San Jose, Costa Rica, on July 6, 2005, on its way to fly over hurricane Dennis to collect data for the Tropical Cloud Systems and Processes mission. The 28-day mission studied how tropical storms form and change intensity and the role upper tropospheric/lower stratospheric processes play in the creation and behavior of these storms. (Photo: NASA)

Above: On August 14, 2005, the Moderate Resolution Imaging Spectroradiometer instrument on NASA's Terra satellite captured this stunning image of forest fires raging across Alaska. Smoke from more than 100 fires (marked in red) filled the state's broad central valley and poured out to sea. Hemmed in by mountains to the north and the south, the smoke spread westward and spilled out over the Bering and Chukchi Seas. NASA's "eyes in the sky" helped the Alaska Department of Environmental Conservation's Division of Air Quality track the movement of smoke, which caused "very unhealthy" and "hazardous" air conditions across the state. (Photo: NASA)



Letter from the Chief Financial Officer

FY 2005 has been an exciting and challenging year for NASA. The first full year of implementation of the President's Vision for Space Exploration has resulted in the reprioritization and restructuring of a significant number of NASA's programs and Centers, significantly impacting budgets and spending across the Agency.

The financial community's ability to respond to those programmatic changes with appropriate financial structure changes, budgetary realignments and process improvements have helped to ensure that NASA's program community continues to execute the NASA mission. We in the financial community have the ultimate responsibility for providing timely and reliable financial information to decision-makers throughout the Agency, and I am determined that we will live up to that responsibility regardless of the challenges we face.

A significant accomplishment in 2005 was the alignment of our financial account structure with the programmatic community's technical work breakdown structure. Not only will this change improve the quality of information provided to decision makers, but it will also significantly improve NASA's ability to track budget to performance for every NASA program and project. With this improvement, NASA continues to retain and enhance its "Green" position on the President's Management Agenda scorecard for Budget and Performance Integration.

Equally important are the significant accomplishments and broad progress that NASA has made in improving its financial management practices. While our auditor's disclaimer of opinion for our FY 2005 financial statements illustrates that we still have room for improvement, the progress we have made has been considerable. For the first time, NASA's FY 2005 financial statements were produced directly from the Agency's single, integrated financial management system—with the shortest preparation time and fewest non-standard adjustments in the Agency's history. Notable in those statements is a 97 percent reduction to our FY 2003 Fund Balance with Treasury imbalance, achieved through an extensive reconciliation and correction process of financial information dating back over 10 years. The implementation of standard monthly reconciliation and monitoring tools will serve to prevent a recurrence of this out of balance condition.

These reconciliation tools are one element of NASA's on-going implementation of the OMB Circular A-123 on Internal Controls. We are educating both our financial community and our program and project managers about the new circular and what it means to be compliant with the tenets of financial internal controls. We have already completed our own risk assessment and are integrating the results into our aggressive plans for addressing NASA's financial management challenges.

NASA has also enhanced its financial management policies, processes, and procedures through the introduction of 13 chapters of our Financial Management Requirements. This effort represents a complete update of the Agency's financial policies. This year, the Agency completed chapters related to internal controls, advances, travel, cash management, and special accounts and funds. FY 2006 enhancements will include budget policies reflecting the bold changes NASA is implementing in its budget formulation process.

NASA has come a long way since the implementation of our Core Financial system three years ago. We are continuing to strive for excellence in financial management and appreciate the efforts of the dedicated men and women in the financial core who are making it happen every day for the people at NASA.

We will continue to execute the initiatives laid out in our Financial Leadership Plan until I am satisfied that we are fully meeting our fiduciary and operating responsibilities to NASA and the American people. I am fully committed to improving the Agency's financial management, and appreciate the employees, contractors, the Office of Inspector General and its external auditors who are providing their efforts and insight as NASA continues on this journey towards financial excellence.

A handwritten signature in black ink that reads "Gwendolyn Sykes". The signature is written in a cursive, flowing style.

Gwendolyn Sykes
Chief Financial Officer

FINANCIAL OVERVIEW

SUMMARY OF FINANCIAL RESULTS, POSITION, AND CONDITION

NASA's financial statements were prepared to report the financial position and results of operations of the Agency. The principal financial statements include: 1) the Consolidated Balance Sheet, 2) the Consolidated Statement of Net Cost, 3) the Consolidated Statement of Changes in Net Position, 4) the Combined Statement of Budgetary Resources, and 5) the Consolidated Statement of Financing. Additional financial information is also presented in the notes and required supplementary schedules.

The Chief Financial Officers Act of 1990 requires that agencies prepare financial statements to be audited in accordance with Government Auditing Standards. The financial statements were prepared from the NASA Integrated Financial Management system in accordance with Generally Accepted Accounting Principles and accounting policies and practices. The statements should be read with the realization that NASA is a component of the U.S. Government, a sovereign entity. The following paragraphs briefly describe the nature of each required financial statement and its relevance. Significant account balances and financial trends are discussed to help clarify their impact upon operations.

CONSOLIDATED BALANCE SHEET

The Consolidated Balance Sheet on page 148 is presented in a comparative format providing financial information for fiscal years 2005 and 2004. It presents assets owned by NASA, amounts owed (liabilities), and amounts that constitute NASA's equity (net position). Net position is presented on both the Consolidated Balance Sheet and the Consolidated Statement of Changes in Net Position.

CONSOLIDATED STATEMENT OF NET COST

The Consolidated Statement of Net Cost on page 149 presents the "income statement" (the annual cost of programs) and along with note 12 displays fiscal year expenses by appropriation symbol. The Net Cost of Operations is reported on the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, and also on the Combined Statement of Financing.

CONSOLIDATED STATEMENT OF CHANGES IN NET POSITION

The Consolidated Statement of Changes in Net Position displayed on page 150 identifies appropriated funds used as a financing source for goods, services, or capital acquisitions. This Statement presents the accounting events that caused changes in the net position section of the Consolidated Balance Sheet from the beginning to the end of the reporting period. Cumulative Results of Operations represents the public's investment in NASA, akin to stockholder's equity in private industry.

COMBINED STATEMENT OF BUDGETARY RESOURCES

The Combined Statement of Budgetary Resources on page 151 highlights budget authority for the Agency and provides information on budgetary resources available to NASA for the year and the status of those resources at the end of the year.

Funding was received and allocated through the following appropriations:

- **Exploration Capabilities**—This appropriation provided for the International Space Station and Space Shuttle programs, including the development of research facilities for the ISS; continuing safe, reliable access to space through augmented investments to improve Space Shuttle safety; support of payload and expendable launch vehicle (ELV) operations; and other investments including innovative technology development, commercialization, research technology development for future exploration, and initial studies for a future crew exploration vehicle.
- **Science, Aeronautics, and Exploration**—This appropriation provided for NASA's research and development activities, including all science activities, global change research, aeronautics, technology investments, education programs, space operations, and direct program support.
- **Inspector General**—This appropriation provided for the workforce and support required to perform audits, evaluations, and investigations of programs and operations.

CONSOLIDATED STATEMENT OF FINANCING

The Consolidated Statement of Financing on page 153 provides the reconciliation between the obligations incurred to finance operations and the net costs of operating programs.

National Aeronautics and Space Administration
Consolidated Balance Sheet
As of September 30, 2005, and September 30, 2004
(In Thousands of Dollars)

	2005	2004
Assets		
Intragovernmental		
Fund balance with Treasury (Note 2)	\$ 8,145,941	\$ 7,629,298
Investments (Note 3)	17,262	17,077
Accounts Receivable, Net (Note 4)	135,863	116,365
Total Intragovernmental	\$ 8,299,066	\$ 7,762,740
Accounts Receivable, Net (Note 4)	\$ 59,783	\$ 49,793
Materials and Supplies (Note 5)	3,019,292	2,952,031
Property, Plant, and Equipment, Net (Note 6)	34,925,646	34,609,217
Advances and Prepaid Expenses	183	97
Total Assets (Note 9)	\$ 46,303,970	\$ 45,373,878
Liabilities		
Intragovernmental		
Accounts Payable	\$ 55,804	\$ 73,972
Other (Notes 7 and 8)	124,691	110,872
Total Intragovernmental	\$ 180,495	\$ 184,844
Accounts Payable	\$ 2,075,700	\$ 2,029,570
Federal Employee and Veterans' Benefits (Note 7)	62,430	68,876
Environmental Cleanup (Note 14)	824,861	986,891
Other (Notes 7 and 8)	339,862	397,834
Total Liabilities	\$ 3,483,348	\$ 3,668,015
Net Position		
Unexpended Appropriations	\$ 5,317,741	\$ 4,771,482
Cumulative Results of Operations	37,502,881	36,934,381
Total Net Position	\$ 42,820,622	\$ 41,705,863
Total Liabilities and Net Position	\$ 46,303,970	\$ 45,373,878

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Net Cost
For the Fiscal Years Ended September 30, 2005, and September 30, 2004
(In Thousands of Dollars)

	<u>2005</u>	<u>2004</u>
Intragovernmental Gross Costs	\$ 1,157,927	\$ 1,056,475
Less: Intragovernmental Earned Revenue	790,707	616,985
Intragovernmental Net Costs	<u>\$ 367,220</u>	<u>\$ 439,490</u>
Gross Costs With the Public	14,927,031	16,051,593
Less: Earned Revenues From the Public	88,054	61,531
Net Costs With the Public	<u>\$ 14,838,977</u>	<u>\$ 15,990,062</u>
Total Net Cost (Note 12)	<u><u>\$ 15,206,197</u></u>	<u><u>\$ 16,429,552</u></u>

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Changes in Net Position
For the Fiscal Years Ended September 30, 2005, and September 30, 2004
(In Thousands of Dollars)

	2005 Cumulative Results of Operations	2005 Unexpended Appropriations	2004 Cumulative Results of Operations	2004 Unexpended Appropriations
Beginning Balances	\$ 36,934,381	\$ 4,771,482	\$ 38,730,277	\$ 4,291,001
Budgetary Financing Sources				
Appropriations Received	—	16,324,048	—	15,380,228
Appropriations Used	15,587,650	(15,587,650)	14,815,775	(14,815,775)
Unexpended Appropriations—Adjustments	—	(190,139)	—	(83,972)
Nonexchange Revenue	35,257	—	15,619	—
Donations	—	—	1	—
Other Financing Sources				
Transfers In/(Out) Without Reimbursement	867	—	(347,480)	—
Imputed Financing	150,923	—	149,741	—
Total Financing Sources	\$ 15,774,697	\$ 546,259	\$ 14,633,656	\$ 480,481
Net Cost of Operations	(15,206,197)	—	(16,429,552)	—
Net Change	568,500	546,259	(1,795,896)	480,481
Ending Balances	\$ 37,502,881	\$ 5,317,741	\$ 36,934,381	\$ 4,771,482

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Combined Statement of Budgetary Resources
For the Fiscal Years Ended September 30, 2005, and September 30, 2004
(In Thousands of Dollars)

	2005	2004
Budgetary Resources		
Budgetary Authority		
Appropriation Received	\$ 16,314,970	\$ 15,457,160
Opening Balance Adjustment (Note 15)	—	13,141
Total Adjusted Appropriations Received	16,314,970	15,470,301
Unobligated Balance		
Beginning of Period (Note 15)	3,102,158	1,763,930
Spending from Offsetting Collections		
Earned		
Collected	851,308	632,069
Receivable From Federal Sources	21,256	57,700
Change in Unfilled Orders		
Advance Received	10,009	(18,904)
Without Advance From Federal Sources	117,356	124,582
Recoveries of Prior Year Obligations, Actual	9,721	1,332,239
Temporarily Not Available		
Permanently Not Available		
Cancellations of Expired/No-Year Accounts	(60,966)	(83,963)
Authority Unavailable Pursuant to Public Law	(129,600)	(91,269)
Total Budgetary Resources	\$ 20,236,212	\$ 19,186,685
Opening Balance Adjustment (Note 15)	—	43,184
Total Adjusted Budgetary Resources	\$ 20,236,212	\$ 19,229,869

National Aeronautics and Space Administration
 Combined Statement of Budgetary Resources, Continued
 For the Fiscal Years Ended September 30, 2005, and September 30, 2004
 (In Thousands of Dollars)

	2005	2004
Status of Budgetary Resources		
Obligations Incurred (Note 13)		
Direct	\$ 16,979,027	\$ 15,313,397
Reimbursable	1,018,592	679,067
Total Obligations Incurred	\$ 17,997,619	\$ 15,992,464
Unobligated Balance		
Apportioned, Currently Available	\$ 2,073,775	\$ 2,353,659
Trust Funds	3,523	3,590
Not Available, Other	161,295	822,691
Total Unobligated Balances (Note 15)	\$ 2,238,593	\$ 3,179,940
Status Budgetary Resources	\$ 20,236,212	\$ 19,172,404
Opening Balance Adjustment (Note 15)	—	57,465
Total Adjusted Status Budgetary Resources	\$ 20,236,212	\$ 19,229,869
Obligated Balance, Net as of October 1 (Note 15)	\$ 4,559,222	\$ 5,798,062
Obligated Balance, End of Period		
Accounts Receivable	(140,089)	(118,833)
Unfilled Customer Orders	(411,458)	(294,103)
Undelivered Orders	4,364,114	2,757,050
Accounts Payable	2,123,963	2,124,642
Outlays		
Disbursements	16,471,978	15,807,247
Collections	(861,317)	(613,164)
Subtotal	\$ 15,610,661	\$ 15,194,083
Less: Offsetting Receipts	—	1
Net Outlays	\$ 15,610,661	\$ 15,194,082
Opening Balance Adjustment (Note 15)	—	(8,011)
Total Adjusted Net Outlays	\$ 15,610,661	\$ 15,186,071

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration
Consolidated Statement of Financing
For the Fiscal Years Ended September 30, 2005, and September 30, 2004
(In Thousands of Dollars)

	2005	2004
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	\$ 17,997,619	\$ 15,992,464
Less: Spending Authority From Offsetting Collections and Recoveries	1,009,650	2,127,686
Obligations Net of Offsetting Collections and Recoveries	16,987,969	13,864,778
Less: Offsetting Receipts	—	1
Net Obligations	16,987,969	13,864,777
Other Resources		
Donations of Property	—	—
Transfers In/Out Without Reimbursements	867	(347,480)
Imputed Financing from Costs Absorbed by Others	150,923	149,741
Net Other Resources Used to Finance Activities	151,790	(197,739)
Total Resources Used to Finance Activities	17,139,759	13,667,038
Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered But Not Yet Provided	(1,389,324)	(955,583)
Resources That Fund Expenses Recognized in Prior Periods	(193,667)	(293,686)
Budgetary Offsetting Collections and Receipts That Do Not Affect the Net Costs of Operations—Other	(35,257)	(13,623)
Opening Balance Adjustment	—	91,933
Resources That Finance the Acquisition of Assets	(4,793,850)	(1,741,671)
Other Resources or Adjustments to Net Obligated Resources That Do Not Affect Net Cost of Operation	(867)	(347,480)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	(6,412,965)	(3,260,110)
Total Resources Used to Finance the Net Cost of Operations	10,726,794	10,406,928

National Aeronautics and Space Administration
Consolidated Statement of Financing, Continued
For the Fiscal Years Ended September 30, 2005, and September 30, 2004
(In Thousands of Dollars)

	2005	2004
Components of Net Cost That Will Not Require or Generate Resources in the Current Period		
Components Requiring or Generating Resources in Future Periods		
Increases in Annual Leave Liability	(4,184)	7,821
Increases in Exchange Revenue Receivable from the Public	27,997	(100,653)
Other	44,764	106,424
Total Components of Net Cost That Will Require or Generate Resources in Future Periods	68,577	13,592
Components Not Requiring or Generating Resources		
Depreciation	4,417,150	5,814,834
Revaluation of Assets or Liabilities	(99)	(14,663)
Other	(6,225)	208,861
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	4,410,826	6,009,032
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	4,479,403	6,022,624
Net Cost of Operations	\$ 15,206,197	\$ 16,429,552

The accompanying notes are an integral part of this statement.

National Aeronautics and Space Administration Notes to Financial Statements

Note 1. Summary of Accounting Policies and Operations

Reporting Entity

The National Aeronautics and Space Administration (NASA) is an independent Agency that was established by Congress on October 1, 1958 by the National Aeronautics and Space Act of 1958. NASA was incorporated from the Agency's predecessor organization, the National Advisory Committee for Aeronautics, which provided technical advice to the United States aviation industry and performed aeronautics research. Today, NASA serves as the fulcrum for initiatives by the U.S. in civil space and aviation.

As of August 2004, NASA is organized into four Mission Directorates which focus on the following objectives:

- Exploration Systems: creating new capabilities for affordable, sustainable human and robotic exploration;
- Space Operations: providing critical enabling technologies for much of the rest of NASA through the Space Shuttle, the International Space Station, and flight support;
- Science: exploring the Earth, moon, Mars, and beyond; charting the best route of discovery, and reaping the benefits of Earth and space exploration for society; and
- Aeronautics Research: pioneering and proving new flight technologies that improve the ability to explore and which have practical applications on Earth.

In addition, NASA has eight Mission Support Offices, including the Office of Education and the Office of Safety and Mission Assurance. The Agency's transformed structure includes a Strategic Planning Council and a supporting Office of Advanced Planning and Integration to enable better long-range planning, an Operations Council to integrate NASA's tactical and operational decisions, and a number of new or reconstituted committees that support NASA's focus and direction. The transformed organizational structure is designed to streamline the Agency and position it to better implement the Vision for Space Exploration.

The nine NASA Centers, NASA Headquarters, and the Jet Propulsion Laboratory carry out the activities of the Mission Directorates. The Jet Propulsion Laboratory is a federally funded Research and Development Center owned by NASA but managed by an independent contractor.

Basis of Accounting and Presentation

These consolidated financial statements have been prepared to report the financial position, net cost of operations, changes in net position, budgetary resources, and financing of NASA, as required by the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. The financial statements were prepared from the books and records of the Agency, in accordance with accounting principles generally accepted (GAAP) in the United States of America and Office of Management and Budget (OMB) Bulletin 01-09, Form and Content of Agency Financial Statements and Circular A-136, Financial Reporting Requirements. GAAP for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), which is the official standard setting body for the federal government.

The financial statements should be read with the realization they are a component of the U.S. government, a sovereign entity. One implication of this is that liabilities cannot be liquidated without legislation providing resources and legal authority to do so. The accounting structure of federal agencies is designed to reflect both accrual and budgetary accounting transactions. Under the accrual method of accounting, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

Budgets and Budgetary Accounting

NASA is funded by three appropriations: Science, Aeronautics and Exploration; Exploration Capabilities; and Office of Inspector General.

The Science, Aeronautics, and Exploration appropriation supports the following programs: Science Mission Directorate; Exploration Systems Mission Directorate; and Aeronautics Research Mission Directorate. The Exploration Capabilities appropriation supports the following programs: Space Operations Mission Directorate, which includes Space Station, Space Shuttle, and Space and Flight Support. The Office of Inspector General appropriation funds the audit and investigation activities of the Agency.

Reimbursements to NASA appropriations are used to fund agreements between the Agency and other Federal entities or the public. As part of its reimbursable program, NASA launches devices into space and provides tracking and data relay services for the U.S. Department of Defense, the National Oceanic and Atmosphere Administration, and the National Weather Service.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

National Aeronautics and Space Administration Notes to Financial Statements

Note 1. Summary of Accounting Policies and Operations, Continued

Fund Balance with Treasury

Treasury processes cash receipts and disbursements for NASA. Fund Balance with Treasury includes appropriated funds, trust funds, deposit funds, and budget clearing accounts.

Investments in U.S. Government Securities

Intragovernmental non-marketable securities includes the following investments:

- National Aeronautics and Space Administration Endeavor Teacher Fellowship Trust Fund established from public donations in tribute to the crew of the Space Shuttle Challenger.
- Science Space and Technology Education Trust Fund established for programs to improve science and technology education.

Accounts Receivable

Most receivables are for reimbursement of research and development costs related to satellites and launch services. The allowance for uncollectible accounts is based upon evaluation of public accounts receivable, considering the probability of failure to collect based upon current status, financial and other relevant characteristics of debtors, and the relationship with the debtor. Under a cross-servicing agreement with the Department of Treasury, public accounts receivable over 180 days delinquent are turned over to Treasury for collection. The receivable remains on NASA's books until Treasury determines the receivable is uncollectible or the receivable is internally written off and closed out.

Prepaid Expenses

Payments in advance of receipt of goods or services are recorded as prepaid expenses at the time of payment and recognized as expenses when related goods or services are received.

Materials and Supplies

Materials held by Centers and contractors that are repetitively procured, stored and issued on the basis of demand are considered materials and supplies. Certain NASA contractors' inventory management systems do not distinguish between items that should be classified as materials and those that should be classified as depreciable property. NASA reclassifies as property, all materials valued at \$100,000 or greater, in support of large-scale assets such as the Space Shuttle and the International Space Station.

Property, Plant, and Equipment

The Agency and its contractors and grantees hold NASA-owned property, plant, and equipment. Property with a unit cost of \$100,000 or more and a useful life of 2 years or more is capitalized; all other property is expensed when purchased. Capitalized costs include all costs incurred by NASA to bring the property to a form and location suitable for its intended use. Under provisions of the Federal Acquisition Regulation (FAR), contractors are responsible for control over accountability for Government-owned property in their possession. NASA's contractors and grantees report on NASA property in their custody annually and its top contractors report monthly.

Capitalized costs for internally developed software include the full costs (direct and indirect) incurred during the software development stage only. For purchased software, capitalized costs include amounts paid to vendors for the software and material internal costs incurred by the Agency to implement and make the software ready for use through acceptance testing. When NASA purchases software as part of a package of products and services (for example: training, maintenance, data conversion, reengineering, site licenses, and rights to future upgrades and enhancements), capitalized and non-capitalized costs of the package are allocated among individual elements on the basis of a reasonable estimate of their relative fair market values. Costs that are not susceptible to allocation between maintenance and relatively minor enhancements are expensed. NASA capitalizes costs for internal use software when the total projected cost is \$1,000,000 or more and the expected useful life of the software is 2 years or more. These Financial Statements report depreciation expense using the straight-line method.

International Space Station

NASA began depreciating the Station in FY 2001 when manned by the first permanent crew. Only the Station's major elements in space are depreciated; any on-ground elements are reported as Assets Under Construction (AUC) until launched and incorporated into the existing Station structure.

Advances from Others

Advances from Others represent amounts advanced by other Federal and non-federal entities for goods or services to be provided and are included in other liabilities in the Financial Statements.

**National Aeronautics and Space Administration
Notes to Financial Statements****Note 1. Summary of Accounting Policies and Operations, Continued****Liabilities Covered by Budgetary Resources**

Liabilities covered by budgetary resources are liabilities that are covered by realized budgetary resources as of the balance sheet date. Realized budgetary resources include new budget authority, unobligated balances of budgetary resources at the beginning of the year, and spending authority from offsetting collections. Examples include accounts payable and salaries. Accounts payable includes amounts recorded for the receipt of goods or services furnished.

Liabilities and Contingencies Not Covered by Budgetary Resources

Generally liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided. Examples include the Federal Employees' Compensation Act (FECA) actuarial liability and contingencies.

Liabilities not covered by budgetary resources include certain environmental matters, legal claims, pensions and other retirement benefits (ORB), workers' compensation, annual leave, and closed appropriations.

Annual, Sick, and Other Leave

Annual leave is accrued as it is earned; the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of non-vested leave are expensed as taken.

Federal Employee and Veterans' Benefits

Agency employees participate in the Civil Service Retirement System (CSRS), a defined benefit plan, or the Federal Employees Retirement System (FERS), a defined benefit and contribution plan. For CSRS employees, NASA makes contributions of 8.51 percent of pay. For FERS employees, NASA makes contributions of 10.7 percent to the defined benefit plan, contributes 1 percent of pay to a retirement saving plan (contribution plan), and matches employee contributions up to an additional 4 percent of pay. For FERS employees, NASA also contributes to employer's matching share for Social Security.

Statement of Federal Financial Accounting Standards No. 5, "Accounting for Liabilities of the Federal Government," require government agencies to report the full cost of employee benefits (FEHB), and the Federal Employees Group Life Insurance (FEGLI) Programs. NASA used the applicable cost factors and imputed financing sources from the Office of Personnel and Management Letter For Chief Financial Officers, dated August 16, 2004, in these Financial Statements.

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 2. Fund Balance With Treasury
(In Thousands of Dollars)

The Fund Balances below represent the total of all undisbursed account balances with the U.S. Treasury summarized by fund type.

Fund Type	Treasury Appropriations Fund Symbol
Trust Funds	8550, 8977, 8978, 8980
Appropriated Funds	0105, 0107, 0108, 0109, 0110, 0111, 0112, 0113, 0114, 0115
Other Funds	1099, 1435, 3200, 3220, 3880, 3875, 3885, 4546, 6050, 6275, 6276

Trust Funds include balances in Endeavor Teacher Fellowship Trust Fund, National Space Grant Program, Science, Space and Technology Education Trust Fund, and Gifts and Donations.

Appropriated Funds include balances in Space Flight Capabilities, Science, Aeronautics, and Exploration, Mission Support, Human Space Flight, Science, Aeronautics, and Technology, and Office of the Inspector General.

Other Fund types include Fines, Penalties, and Forfeitures, General Fund Proprietary Interest, Working Capital Fund, Collections of Receivables from Canceled Appropriations, General Fund Proprietary Receipts, Budget Clearing and Suspense, Unavailable Check Cancellation, Undistributed Intergovernmental Payment, State and Local Taxes, Other Payroll, and US Employee Allotment Account, Savings Bond.

Fund Balances

	<u>2005</u>	<u>2004</u>
Trust Funds	\$ 3,595	\$ 3,592
Appropriated Funds	8,169,040	7,645,106
Other Fund Types	(26,694)	(19,400)
Total	\$ 8,145,941	\$ 7,629,298

The status of Fund Balance with Treasury represents the total fund balance as reflected in the general ledger for unobligated and obligated balances. Unobligated Balances—Available represent the amount remaining in appropriation accounts that are available for obligation in future fiscal years. Unobligated Balances—Unavailable represent the amount remaining in appropriation accounts that can only be used for adjustments to previously recorded obligations. Obligated Balances—Not Yet Disbursed represent the cumulative amount of obligations incurred, including accounts payable and advances from reimbursable customers, for which outlays have not been made.

Status of Fund Balance With Treasury

	<u>2005</u>
Unobligated Balance	
Available	\$ 2,077,298
Unavailable	161,295
Obligated Balance Not Yet Disbursed	5,936,531
Clearing and Deposit Accounts	(29,183)
Total	\$ 8,145,941

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 3. Investments

(In Thousands of Dollars)

Intragovernmental Securities are marketable federal securities bought and sold on the open market. The Bureau of the Public Debt issues non-marketable par value Treasury securities. The trust fund and cash balances are invested in Treasury securities, which are purchased and redeemed at par exclusively through Treasury's Federal Investment Branch. The effective-interest method was utilized to amortize discounts and premiums.

Amounts for 2005 Balance Sheet Reporting

	Cost	Amortization Method	Unamortized (Premium) Discount	Investments, Net	Other Adjustments	Market Value Disclosure
Intragovernmental Securities						
Non-marketable						
Par Value	\$ 14,215	Effective-interest 0.0298–8.875%	\$ 2,897	\$ 17,112	—	\$ 17,112
Subtotal			\$ 2,897	\$ 17,112	—	\$ 17,112
Accrued Interest	150					150
Total	\$ 14,365					\$17,262

Amounts for 2004 Balance Sheet Reporting

	Cost	Amortization Method	Unamortized (Premium) Discount	Investments, Net	Other Adjustments	Market Value Disclosure
Intragovernmental Securities						
Non-marketable						
Par Value	\$ 14,067	Effective-interest 0.0846–6.6%	\$ 2,862	\$ 16,929	—	\$ 16,929
Subtotal			\$ 2,862	\$ 16,929	—	\$ 16,929
Accrued Interest	148					148
Total	\$ 14,215					\$17,077

National Aeronautics and Space Administration
Notes to Financial Statements

Note 4. Accounts Receivable, Net
(In Thousands of Dollars)

The Accounts Receivable balance includes receivables for reimbursement of research and development costs related to satellites and launch services. The allowance for uncollectible accounts is based upon evaluation of public accounts receivables, considering the probability of failure to collect based upon current status, financial and other relevant characteristics of debtors, and the relationship with the debtor. The allowance for uncollectible accounts was not established for intragovernmental accounts receivables for FY 2005.

September 30, 2005			
	Accounts Receivable	Allowance for Uncollectible Accounts	Net Realizable Value
Intragovernmental	\$ 135,863	\$ —	\$ 135,863
Public	60,709	(926)	59,783
Total	\$ 196,572	\$ (926)	\$ 195,646

September 30, 2004			
	Accounts Receivable	Allowance for Uncollectible Accounts	Net Realizable Value
Intragovernmental	\$ 116,365	\$ —	\$ 116,365
Public	50,591	(798)	49,793
Total	\$ 166,956	\$ (798)	\$ 166,158

Note 5. Inventory and Related Property, Net
(In Thousands of Dollars)

Operating Materials and Supplies, Held for Use are tangible personal property held by NASA and its contractors to be used for fabricating and maintaining NASA assets. The property will be consumed in normal operations. Operating Materials and Supplies, Held in Reserve for Future Use are tangible personal property held by NASA for emergencies for which there is no normal recurring demand, but that must be immediately available to preclude delay that might result in loss, damage, or destruction of government property, danger to life or welfare of personnel, or substantial financial loss to the government due to an interruption of operations. All materials are valued using historical costs, or other valuation methods that approximate historical cost. NASA Centers and contractors are responsible for continually reviewing materials and supplies to identify items no longer needed for operational purposes or that need to be replaced. Excess operating materials and supplies are materials that exceed the demand expected in the normal course of operations, and do not meet management's criteria to be held in reserve for future use. Obsolete operating material and supplies are materials no longer needed due to changes in technology, laws, customs, or operations. Unserviceable operating materials and supplies are materials damaged beyond economic repair. The Operating Materials and Supplies balance reported in the FY 2004 Financial Statements was net of the excess, obsolete, and unserviceable data.

	2005	2004
Operating Materials and Supplies		
Held for Use	\$ 3,401,708	\$ 2,948,792
Held in Reserve for Future Use	2,899	3,239
Excess, Obsolete, and Unserviceable	(385,315)	—
Total	\$ 3,019,292	\$ 2,952,031

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 6. General Property, Plant, and Equipment, Net
(In Thousands of Dollars)

Theme Assets consist of property, plant and equipment specifically designed for use in a NASA program. "Equipment" includes special tooling, special test equipment, and Agency-peculiar property, such as the Space Shuttle and other configurations of spacecraft: engines, unlaunched satellites, rockets, and other scientific components unique to NASA space programs. "Structures, Facilities, and Leasehold Improvements" includes buildings with collateral equipment, and capital improvements, such as airfields, power distribution systems, flood control, utility systems, roads, and bridges. NASA also has use of certain properties at no cost. These properties include land at the Kennedy Space Center withdrawn from the public domain, land, and facilities at the Marshall Space Flight Center under a no cost, 99-year lease with the U.S. Department of the Army. Work-in-Process is the cost incurred for property, plant, and equipment items not yet completed. Work-in-Process includes equipment and facilities that are being constructed. WIP includes the fabrication of assets that may or may not be capitalized once completed and operational. Assets Under Construction represents the costs of fabricating a Theme Asset. These costs are capitalized in their year of operation. If it is determined to not meet capitalization criteria (i.e., less than two years useful life), the project will be expensed to the Statement of Net Cost.

NASA has Station bartering agreements with international agencies including the European Space Agency and the National Space Agency of Japan. NASA barterers with these other space agencies to obtain Station hardware elements in exchange for providing goods and services such as Space Shuttle transportation and a share of NASA's Station utilization rights. The intergovernmental agreements state that the parties will seek to minimize the exchange of funds in the cooperative program, including the use of barter to provide goods and services. As of September 30, 2005, NASA has received some assets from these parties in exchange for future services. However, due to the fact that the fair value is indeterminable, no value was ascribed to these transactions in accordance with APB No. 29. Under all agreements to date, NASA's Station Program's International Partners Office expects that NASA will eventually receive future NASA-required elements as well with no exchange of funds.

NASA reports the physical existence (in terms of physical units) of heritage assets as part of the required supplemental stewardship information.

On January 14, 2004, President Bush announced a new vision for the Nation's space exploration program. Implementation of this initiative has required NASA to prioritize and restructure existing programs and missions, and to phase out sooner than originally planned, or eliminate all together over the next several years, some programs and missions. These programs and missions include the Shuttle, which was originally planned to continue to the year 2020 but now will retire as soon as assembly of the International Space Station is completed (planned for the end of this decade), and the possible cancellation of planned servicing missions to the Hubble Space Telescope.

September 30, 2005

	Depreciation Method	Useful Life	Cost	Accumulated Depreciation	Book Value
Government-owned/Government-held					
Land	—	—	\$ 114,136	\$ —	\$ 114,136
Structures, Facilities, and Leasehold Improvements	Straight-line	15–40 years	5,566,852	(4,008,284)	1,558,568
Theme Assets	Straight-line	2–20 years	42,120,987	(25,699,312)	16,421,675
Equipment	Straight-line	5–25 years	2,108,986	(1,483,309)	625,677
Capitalized Leases (Note 10)	Straight-line	5–25 years	1,705	(609)	1,096
Internal Use Software and Development	Straight-line	5 years	88,476	(25,902)	62,574
Work-in-Process (WIP)					
Work-in-Process			199,439	—	199,439
Work-in-Process Equipment			26,039	—	26,039
Assets Under Construction			6,952,974	—	6,952,974
Total			\$ 57,179,594	\$ (31,217,416)	\$ 25,962,178

National Aeronautics and Space Administration
Notes to Financial Statements

Note 6. General Property, Plant, and Equipment, Net, Continued
(In Thousands of Dollars)

September 30, 2005, Continued

	Depreciation Method	Useful Life	Cost	Accumulated Depreciation	Book Value
Government-owned/Contractor-held					
Land	—	—	\$ 8,076	\$ —	\$ 8,076
Structures, Facilities, and Leasehold Improvements	Straight-line	15–40 years	830,893	(628,063)	202,830
Equipment	Straight-line	5–25 years	10,921,290	(8,422,060)	2,499,230
Work-in-Process			6,253,332	—	6,253,332
Total			\$ 18,013,591	\$ (9,050,123)	\$ 8,963,468
Total Property, Plant, and Equipment			\$ 75,193,187	\$ (40,267,539)	\$ 34,925,646

National Aeronautics and Space Administration
Notes to Financial Statements

Note 6. General Property, Plant, and Equipment, Net, Continued
(In Thousands of Dollars)

September 30, 2004

	Depreciation Method	Useful Life	Cost	Accumulated Depreciation	Book Value
Government-owned/Government-held					
Land	—	—	\$ 115,132	\$ —	\$ 115,132
Structures, Facilities, and Leasehold Improvements	Straight-line	15–40 years	5,305,594	(3,839,144)	1,466,450
Theme Assets	Straight-line	2–20 years	40,456,990	(22,450,519)	18,006,471
Equipment	Straight-line	5–25 years	2,018,816	(1,338,509)	680,307
Capitalized Leases (Note 10)	Straight-line	5–25 years	4,920	(316)	4,604
Internal Use Software and Development	Straight-line	5 years	31,839	(9,957)	21,882
Work-in-Process (WIP)					
Work-in-Process			180,905	—	180,905
Work-in-Process Equipment			26,949	—	26,949
Assets Under Construction			5,600,830	—	5,600,830
Total			\$ 53,741,975	\$ (27,638,445)	\$ 26,103,530
Government-owned/Contractor-held					
Land	—	—	\$ 8,076	\$ —	\$ 8,076
Structures, Facilities, and Leasehold Improvements	Straight-line	15–40 years	801,131	(542,559)	258,572
Equipment	Straight-line	5–20 years	9,947,438	(7,862,657)	2,084,781
Work-in-Process			6,154,258	—	6,154,258
Total			\$ 16,910,903	\$ (8,405,216)	\$ 8,505,687
Total Property, Plant, and Equipment			\$ 70,652,878	\$ (36,043,661)	\$ 34,609,217

National Aeronautics and Space Administration
Notes to Financial Statements

Note 7. Liabilities Not Covered by Budgetary Resources
(In Thousands of Dollars)

Liabilities not covered by budgetary resources are liabilities for which Congressional action is needed before budgetary resources can be provided. They include certain environmental matters (Note 14), legal claims, pensions and other retirement benefits, workers' compensation, annual leave, and closed appropriations. Only a portion of these liabilities will require or generate resources in future periods.

No balances have been recorded in the financial statements for contingencies related to proceedings, actions, and claims where management and legal counsel believes that it is possible but not probable that some costs will be incurred. These contingencies range from zero to \$142 million and from zero to \$127 million, as of September 30, 2005 and September 30, 2004, respectively.

NASA is a party in various administrative proceedings, court actions (including tort suits), and claims brought by or against it. In the opinion of management and legal counsel, the ultimate resolution of these proceedings, actions and claims will not materially affect the financial position, net cost, changes in net position, budgetary resources, or financing of NASA. Liabilities have been recorded for \$5 million and \$36 million for these matters as of September 30, 2005 and September 30, 2004, respectively.

A liability was recorded for workers' compensation claims related to the Federal Employees' Compensation Act (FECA), administered by U.S. Department of Labor. The FECA provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. The FECA Program initially pays valid claims and subsequently seeks reimbursement from the federal agencies employing the claimants.

The FECA liability includes the actuarial liability for estimated future costs of death benefits, workers' compensation, and medical and miscellaneous costs for approved compensation cases. The present value of these estimates at the end of fiscal year was calculated by the Department of Labor using a discount rate. This liability does not include the estimated future costs for claims incurred but not reported or approved as of September 30, 2005.

Fiscal Year	Discount Rate
2005	4.528%
2004	4.883%

NASA has recorded Accounts Payable related to closed appropriations for which there are contractual commitments to pay. These payables will be funded from appropriations available for obligation at the time a bill is processed, in accordance with Public Law 101-510.

	2005	2004
Intragovernmental		
Worker's Compensation	\$ 15,211	\$ 15,787
Accounts Payable for Closed Appropriations	2,097	3,989
Total Intragovernmental	\$ 17,308	\$ 19,776
From the Public		
Environmental Cleanup Costs	\$ 824,861	\$ 986,891
Unfunded Annual Leave	170,631	166,448
Actuarial FECA Liability	62,430	68,876
Contingent Liabilities	5,328	36,205
Subtotal	\$ 1,063,250	\$ 1,258,420
Accounts Payable for Closed Appropriations	\$ 116,593	\$ 79,306
Total From the Public	\$ 1,179,843	\$ 1,337,726
Total Liabilities Not Covered by Budgetary Resources	\$ 1,197,151	\$ 1,357,502
Total Liabilities Covered by Budgetary Resources	2,286,197	2,310,513
Total Liabilities	\$ 3,483,348	\$ 3,668,015

National Aeronautics and Space Administration
Notes to Financial Statements

Note 8. Other Liabilities
(In Thousands of Dollars)

September 30, 2005

	Current	Non-current	Total
Intragovernmental Liabilities			
Advances From Others	\$ 99,321	\$ —	\$ 99,321
Workers' Compensation	(576)	15,787	15,211
Employer Contributions and Payroll Taxes	10,482	—	10,482
Liability for Deposit and Clearing Funds	(385)	—	(385)
Custodial Liability	5,459	—	5,459
Other Liabilities	(5,397)	—	(5,397)
Subtotal	108,904	15,787	124,691
Accounts Payable for Closed Appropriations	313	1,784	2,097
Total Intragovernmental	\$ 109,217	\$ 17,571	\$ 126,788
Liabilities From the Public			
Unfunded Annual Leave	\$ —	\$ 170,631	\$ 170,631
Employer Contributions and Payroll Taxes	6,355	—	6,355
Accrued Funded Payroll	70,769	—	70,769
Advances From Others	61,704	—	61,704
Contract Holdbacks	1,452	—	1,452
Custodial Liability	10,825	—	10,825
Other Accrued Liabilities	27,481	—	27,481
Contingent Liabilities	—	5,327	5,327
Lease Liabilities	160	—	160
Liability for Deposit and Clearing Funds	(20,691)	—	(20,691)
Other Liabilities	5,849	—	5,849
Subtotal	163,904	175,958	339,862
Accounts Payable for Closed Appropriations	39,398	77,195	116,593
Actuarial FECA Liability	—	62,430	62,430
Total Liabilities From the Public	\$ 203,302	\$ 315,583	\$ 518,885
Total Other Liabilities	\$ 312,519	\$ 333,154	\$ 645,673

National Aeronautics and Space Administration
Notes to Financial Statements

Note 8. Other Liabilities, Continued
(In Thousands of Dollars)

September 30, 2004

	Current	Non-current	Total
Intragovernmental Liabilities			
Advances From Others	\$ 90,568	\$ —	\$ 90,568
Workers' Compensation	6,854	8,933	15,787
Employer Contributions and Payroll Taxes	440	—	440
Liability for Deposit and Clearing Funds	781	—	781
Custodial Liability	2,082	—	2,082
Other Liabilities	1,214	—	1,214
Subtotal	101,939	8,933	110,872
Accounts Payable for Closed Appropriations	947	3,042	3,989
Total Intragovernmental	\$ 102,886	\$ 11,975	\$ 114,861
Liabilities From the Public			
Unfunded Annual Leave	\$ —	\$ 166,448	\$ 166,448
Employer Contributions and Payroll Taxes	14,324	—	14,324
Accrued Funded Payroll	59,037	—	59,037
Advances From Others	82,838	—	82,838
Contract Holdbacks	2,509	—	2,509
Custodial Liability	(2,082)	—	(2,082)
Other Accrued Liabilities	21,438	—	21,438
Contingent Liabilities	—	36,205	36,205
Lease Liabilities	2,255	—	2,255
Liability for Deposit and Clearing Funds	9,189	—	9,189
Other Liabilities	5,673	—	5,673
Subtotal	195,181	202,653	397,834
Accounts Payable for Closed Appropriations	34,746	44,560	79,306
Actuarial FECA Liability	—	68,876	68,876
Total Liabilities From the Public	\$ 229,927	\$ 316,089	\$ 546,016
Total Other Liabilities	\$ 332,813	\$ 328,064	\$ 660,877

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 9. Non-Entity Assets
(In Thousands of Dollars)

Non-Entity Assets are those assets that are held by NASA, but are not available for use by NASA. NASA's non-entity assets include accounts receivable related to closed appropriations, which will be deposited in miscellaneous receipts.

	<u>2005</u>	<u>2004</u>
Intragovernmental		
Accounts Receivable	\$ 5,458	\$ 2,082
Total Intragovernmental	\$ 5,458	\$ 2,082
Due From the Public		
Accounts Receivable	10,825	(2,082)
Total Non-Entity Assets	\$ 16,283	\$ —
Total Entity Assets	\$ 46,287,687	\$ 45,373,878
Total Assets	\$ 46,303,970	\$ 45,373,878

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 10. Leases

(In Thousands of Dollars)

Entity as Lessee—Capital Leases	As of September 30	
	2005	2004
Summary of Assets Under Capital Lease		
Equipment	\$ 1,705	\$ 4,920
Accumulated Amortization of Liability	(1,545)	(2,665)
Total	\$ 160	\$ 2,255

Capital Leases consist of assorted types of machinery with non-cancelable terms longer than one year, a fair market value of \$100,000 or more, a useful life of two years or more, and agreement terms equivalent to an installment purchase.

Future Minimum Lease Payments	Fiscal Year	Equipment
	2006	\$ 161
	2007	—
	2008	—
	2009 and After	—
	Total Future Lease Payments	\$ 161
	Less: Imputed Interest	(1)
	Net Capital Lease Liability	\$ 160

Lease Liabilities Covered by Budgetary Resources	\$ 160
Lease Liabilities Not Covered by Budgetary Resources	—
Total Lease Liabilities	\$ 160

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 10. Leases, Continued
(In Thousands of Dollars)

Operating Leases

Operating Leases includes those leases that are not Capital Leases and are for a non-cancelable period in excess of one year. NASA's FY 2005 Operating Leases include tower rental, a communications Earth station, warehouse storage, copiers, office trailers, and land.

Future Payments Due

Fiscal Year	Land and Buildings	Equipment	Total
2006	\$ 14	\$ 11,755	\$ 11,769
2007	14	8,530	8,544
2008	14	—	14
2009	14	—	14
2010 and After	14	—	14
Total Future Lease Payments	\$ 70	\$ 20,285	\$ 20,355

Entity as Lessor: Operating Leases

NASA leases and allows use of its land and facilities by the public and other government agencies for a fee.

Future Projected Receipts

Fiscal Year	Land and Buildings
2006	\$ 399
2007	379
2008	376
2009	72
2010 and After	770
Total Future Operating Lease Receivables	\$ 1,996

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 11. Gross Cost and Earned Revenue by Budget Functional Classification

The breakdown of Gross Cost and Earned Revenue by Budget Functional Classification code was not available for fiscal years 2004 or 2005, as it was configured in SAP at the beginning of the fiscal year to capture the code on the transactions as they occurred.

NASA defined the mapping structure and configured the structure within SAP before FY 2006 opened. Accordingly, NASA will have the means to prepare the breakdown of Gross Cost and Earned Revenue by Budget Functional Classification code for FY 2006.

Note 12. Net Cost by Major Program

(In Thousands of Dollars)

	<u>2005</u>
Science, Aeronautics, and Exploration	\$ 7,518,532
Exploration Capabilities	7,946,173
Cross-Agency Support Programs	(258,508)
Net Cost of Operations	<u>\$ 15,206,197</u>
	<u>2004</u>
Science, Aeronautics, and Exploration	\$ 8,558,763
Space Flight Capabilities	6,395,861
Cross-Agency Support Programs	1,474,928
Net Cost of Operations	<u>\$ 16,429,552</u>

Cross-Agency Support Programs includes the costs of purchasing, disposing, and operating property, plant, and equipment, as well as those for the Office of Inspector General, reimbursable revenue, and other miscellaneous expenses.

Note 13. Apportionment Categories of Obligations Incurred

(In Thousands of Dollars)

	<u>2005</u>	<u>2004</u>
Direct Obligations		
Category A	\$ 1,000	\$ 1,000
Category B	16,978,027	15,312,397
Reimbursable Obligations		
Category B	1,018,592	679,067
Total Obligations Incurred	<u>\$ 17,997,619</u>	<u>\$ 15,992,464</u>

NASA compared the amounts reported on the Statement of Budgetary Resources and the actual amounts reported in the Budget of the United States Government as required by SFFAS No. 7 for FY 2004 and identified no material differences.

The Budget of the United States Government with actual amounts from FY 2005 was not published as of November 15, 2005. The comparison for FY 2005 will be performed when the Budget of the United States Government is published.

Category A consists of amounts requested to be apportioned for each calendar quarter in the fiscal year. Category B consists of amounts requested to be apportioned on a basis other than calendar quarters, such as time periods other than quarters, activities, projects, objects, or a combination thereof.

**National Aeronautics and Space Administration
Notes to Financial Statements**

Note 14. Environmental and Disposal Liabilities
(In Thousand of Dollars)

Environmental and Disposal Liabilities represent cleanup costs from NASA operations that resulted in contamination from waste disposal methods, leaks, spills, and other past activity that created a public health or environmental risk. Federal, state, and local statutes and regulations require environmental cleanup costs. Some of these statutes are the Comprehensive Environmental Response, Compensation, and Liability Act; the Resource Conservation and Recovery Act; the Nuclear Waste Policy Act of 1982; and State and local laws.

Where up-to-date, site-specific engineering estimates for cleanup are not available, NASA employs commercially available parametric modeling software to estimate the total cost of cleaning up known contamination at these sites over future years.

NASA recorded an unfunded liability in its financial statements to reflect the estimated total cost of environmental cleanup. This estimate could change in the future due to identification of additional contamination, inflation, deflation, and a change in technology or applicable laws and regulations as well as through ordinary liquidation of these liabilities as the cleanup program continues into the future. The estimate represents an amount that NASA expects to spend to remediate currently known contamination, subject to the availability of appropriated funds. Other responsible parties that may be required to contribute to the remediation funding could share this liability.

	<u>2005</u>	<u>2004</u>
Environmental Liabilities	\$ 824,861	\$ 986,891
Total Environmental and Disposal Liabilities	\$ 824,861	\$ 986,891

Note 15. General Information

During fiscal year 2003, NASA replaced ten disparate accounting systems and over 120 ancillary subsystems that had been in operation at our Centers for the past two decades, with a commercial off-the-shelf, Agency-wide, Integrated Financial Management system (SAP Core Financials application module). We anticipated the challenges of implementing an organization-wide integrated financial management system and adopting full cost business practices at the Agency, and developed an ambitious but doable plan that spans multiple years to resolve system conversion data problems, and system configuration and functionality limitations.

NASA closed fiscal year 2003 and 2004 with a number of known reconciling items, most of which were resolved during fiscal year 2005. Some resolutions required processing corrective transactions in the financial management system that impact line items on the financial statements.

NASA management decided to process all corrections in the current fiscal year based on the number of transactions for correction, the time frame for processing corrections, and the complexity and functionality of the financial management system. The correction methodology classified some transactions that would potentially have been a prior period adjustment as a current year transaction, possibly overstating current year nominal accounts.

In addition, the reconciling items from fiscal year 2003 and 2004 resulted in the opening balances in some real accounts being misstated or misclassified by Treasury data attribute when fiscal year 2005 opened. The resolution of the reconciling items during fiscal year 2005 provided NASA with solid base to open fiscal year 2006.

NASA used the NASA Audit Tracking Systems (NATS) as the internal control process to track, monitor, and review all corrections processed in the financial management system, as the financial management system did not lend itself to providing detailed tracking of all corrections.

NASA has one key finding from the prior fiscal years that was not resolved during fiscal year 2005. The financial management system has limited functionality that could not be configured to capture the Recovery of Prior Year Obligations (upward and downward obligation adjustments) at the obligation level.

Management is exploring whether a significant portion of PP&E costs are research and development and therefore should be expensed. NASA intends to resolve the accounting policy aspects of its theme asset accounting in FY 2006.

**National Aeronautics and Space Administration
 Required Supplementary Stewardship Information
 Stewardship Property, Plant, and Equipment: Heritage Assets
 For the Fiscal Year Ended September 30, 2005**

Federal agencies are required to classify and report Heritage Assets, in accordance with the requirements of SFFAS No. 8, Supplementary Stewardship Reporting.

Heritage Assets are property, plant, and equipment that possess one or more of the following characteristics: historical or natural significance; cultural, educational, or aesthetic value; or significant architectural characteristics.

Since the cost of Heritage Assets is usually not determinable, NASA does not value them or establish minimum value thresholds for designation of property, plant, or equipment as Heritage Assets. Additionally, the useful lives of Heritage Assets are not reasonably estimable for depreciation purposes. Since the most relevant information about Heritage Assets is their existence, they are qualified in terms of physical units, as follows:

	2004	Additions	Withdrawals	2005
Buildings and Structures	36	1	0	37
Air and Space Museum Displays and Artifacts	496	4	8	492
Art and Miscellaneous Items	1,016	5	0	1,021
Total Heritage Assets	1,548	10	8	1,550

Heritage Assets were generally acquired through construction by NASA or its contractors, and are expected to remain in this category, except where there is legal authority for transfer or sale. Heritage Assets are generally in fair condition, suitable only for display.

Many of the buildings and structures are designated as National Historic Landmarks. Numerous aircraft, spacecraft, and related components are on display at various locations to enhance public understanding of NASA programs. NASA eliminated their cost from its property records when they were designated as Heritage Assets. A portion of the amount reported for deferred maintenance is for Heritage Assets.

For more than 30 years, the NASA Art Program has documented America's major accomplishments in aeronautics and space. During that time, artists generously have contributed their time and talent to record their impressions of the U.S. Aerospace Program in paintings, drawings, and other media. Not only do these art works provide a historic record of NASA projects, they give the public a new and fuller understanding of advancements in aerospace. Artists give a special view of NASA through the "back door." Some have witnessed astronauts in training or scientists at work. The art collection, as a whole, depicts a wide range of subjects, from Space Shuttle launches to aeronautics research, Hubble Space Telescope, and even virtual reality.

Artists commissioned by NASA receive a small honorarium in exchange for donating a minimum of one piece to the NASA archive. In addition, more works have been donated to the National Air and Space Museum.

In accordance with SFFAS No. 8, Heritage Assets that are used in day-to-day government operations are considered "multi-use" Heritage Assets that are not used for heritage purposes. Such assets are accounted for as general property, plant, and equipment and are capitalized and depreciated in the same manner as other general property, plant, and equipment. NASA has 45 buildings and structures considered to be multi-use Heritage Assets. The values of these assets are included in the property, plant, and equipment values shown in the Financial Statements.

**National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development
For the Fiscal Year Ended September 30, 2005**

(In Thousands of Dollars)

Research and Development Expenses by Enterprise by Programs/Applications

In August 2004, NASA restructured from six strategic Enterprises—Human Exploration and Development of Space, Space Science, Earth Science, Biological and Physical Research, Aerospace Technology, and Education Programs—to four Mission Directorates: Exploration Systems, Space Operations, Science, and Aeronautics Research.

The organizational transformation of the six strategic Enterprises to the four Mission Directorates occurred too late in FY 2004 to capture costs, most of which were already incurred, by Mission Directorate and did not provide sufficient lead time to develop the reporting structure in the financial management system for FY 2005.

During FY 2005, NASA developed an organization structure that will allow reporting by mission directorate. The new structure will be implemented in the financial management system with the open of FY 2006. Accordingly, NASA will have the means to prepare the stewardship investments for research and development schedule for FY 2006.

National Aeronautics and Space Administration
 Required Supplementary Stewardship Information
 Stewardship Investments: Research and Development, Continued
 For the Fiscal Years Ended September 30
 (In Thousands of Dollars)

Research and Development Expenses by Enterprise by Programs/Applications

	2003	2002	2001
Human Exploration and Development of Space (HEDS)			
Space Operations			
Basic Research	\$ 69,342	\$ 369,737	\$ 147,869
Applied Research	—	—	92,419
Development	—	—	129,386
Subtotal	\$ 69,342	\$ 369,737	\$ 369,674
Investment and Support (a)			
Basic Research	\$ —	\$ —	\$ —
Applied Research	—	27,453	164,241
Development	—	—	—
Subtotal	\$ —	\$ 27,453	\$ 164,241
Payload Utilization and Operations			
Basic Research	\$ —	\$ —	\$ —
Applied Research	217,999	180,888	153,324
Development	—	—	—
Subtotal	\$ 217,999	\$ 180,888	\$ 153,324
HEDS Total	\$ 287,341	\$ 578,078	\$ 687,239
Space Science (SSE)			
Space Science			
Basic Research	\$ 995,286	\$ 988,677	\$ 581,163
Applied Research	—	—	—
Development	1,761,738	1,836,115	1,179,937
Subtotal	\$ 2,757,024	\$ 2,824,792	\$ 1,761,100
Planetary Exploration			
Basic Research	\$ —	\$ —	\$ —
Applied Research	—	—	—
Development	—	—	—
Subtotal	—	—	—
SSE Total	\$ 2,757,024	\$ 2,824,792	\$ 1,761,100

National Aeronautics and Space Administration
 Required Supplementary Stewardship Information
 Stewardship Investments: Research and Development, Continued
 For the Fiscal Years Ended September 30
 (In Thousands of Dollars)

Research and Development Expenses by Enterprise by Programs/Applications

	2003	2002	2001
Earth Science (ESE)			
Basic Research	\$ 629,343	\$ 544,676	\$ 255,678
Applied Research	71,055	105,661	55,161
Development	568,439	837,850	434,577
ESE Total	\$ 1,268,837	\$ 1,488,187	\$ 745,416
Biological and Physical Research (BPR) (b)			
Basic Research	\$ 396,351	\$ 209,573	\$ 69,603
Applied Research	804,673	415,546	112,221
Development	129,013	95,064	32,338
BPR Total	\$ 1,330,037	\$ 720,183	\$ 214,162
Aerospace Technology (AT)			
Aerospace Technology			
Basic Research	\$ —	\$ —	\$ —
Applied Research	1,083,956	2,398,468	1,039,635
Development	—	—	—
Subtotal	\$ 1,083,956	\$ 2,398,468	\$ 1,039,635
Advanced Space Transportation			
Basic Research	\$ —	\$ —	\$ —
Applied Research	5,533	16,049	83,971
Development	—	—	—
Subtotal	\$ 5,533	\$ 16,049	\$ 83,971
Commercial Technology			
Basic Research	\$ 3,776	\$ —	\$ —
Applied Research	104,105	342,302	127,697
Development	—	12,415	—
Subtotal	\$ 107,881	\$ 354,717	\$ 127,697
AT Total	\$ 1,197,370	\$ 2,769,234	\$ 1,251,303
Education (Formerly Academic Programs)			
Basic Research	\$ 121,649	\$ 81,271	\$ 97,112
Applied Research	47,307	33,844	42,017
Development	—	—	—
Education Total	\$ 168,956	\$ 115,115	\$ 139,129
Total Research and Development Expenses by Program	\$ 7,009,565	\$ 8,495,589	\$ 4,798,349

National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development, Continued
For the Fiscal Years Ended September 30
(In Thousands of Dollars)

Non-research and Development Expenses by Enterprise by Programs/Applications

	2003	2002	2001
Human Exploration and Development of Space (HEDS)			
Space Shuttle	\$ 3,008,610	\$ 3,232,011	\$ 2,100,835
Space Station	1,510,049	1,727,749	(1,253,026)
Investment and Support	145,031	438,428	—
Space Communication Services	295,008	(18,363)	25,776
Safety, Reliability, and Quality Assurance	—	69,868	40,037
Mission Communication Services	(46,608)	253,654	32,199
U.S. Russian Cooperative	52	(2)	208
HEDS Total	\$ 4,912,142	\$ 5,703,345	\$ 946,029
Space Science (SSE)			
Planetary Exploration	—	(232)	787
SSE Total	\$ —	\$ (232)	\$ 787
Other Programs	\$ 53,940	\$ 138,969	\$ 131,737
Reimbursable Expenses	\$ —	\$ —	\$ —
Total Non-research and Development Expenses by Program	\$ 4,966,082	\$ 5,842,082	\$ 1,078,553
Total Program Expenses	\$ 11,975,647	\$ 14,337,671	\$ 5,876,902

NASA makes substantial research and development investments for the benefit of the United States. These amounts are expensed as incurred in determining the net cost of operations.

NASA's research and development programs include activities to extend our knowledge of Earth, its space environment, and the universe, and to invest in new aeronautics and advanced space transportation technologies that support the development and application of technologies critical to the economic, scientific, and technical competitiveness of the United States.

Investment in research and development refers to those expenses incurred to support the search for new or refined knowledge and ideas and for the application or use of such knowledge and ideas for the development of new or improved products and processes, with the expectation of maintaining or increasing national economic productive capacity or yielding other future benefits. Research and development is composed of the following:

Basic research: Systematic study to gain knowledge or understanding of the fundamental aspects of phenomena and of observable facts without specific applications toward processes or products in mind;

Applied research: Systematic study to gain knowledge or understanding necessary for determining the means by which a recognized and specific need may be met; and

Development: Systematic use of the knowledge and understanding gained from research for the production of useful materials, devices, systems, or methods, including the design and development of prototypes and processes.

The strategies and resources that NASA uses to achieve its performance objectives are highlighted in the Management's Discussion & Analysis (MD&A) section of this Performance and Accountability Report. The MD&A also provides information regarding the relationship between performance outcomes and outputs to the stewardship investments outlined above. See the MD&A section entitled "FY 2005 Performance Achievement Highlights," for further details.

**National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development, Continued
For the Fiscal Years Ended September 30**

(a) In FY 2002, NASA's appropriation structure was realigned to incorporate the functions of the former Mission Support appropriation to Science, Aeronautics, and Technology and Human Space Flight. This realignment changed the functionality from a Research and Development Program to both Research and Development and Non-Research and Development, as indicated on the schedule above.

(b) In FY 2001, NASA established a new Enterprise, Biological and Physical Research. This initiative transferred Life and Microgravity Science Applications to Biological and Physical Research.

Enterprise/Program/Application Descriptions

Human Exploration and Development of Space seeks to expand the frontiers of space and knowledge by exploring, using, and enabling the development of space.

Space Station, or International Space Station is a complex of research laboratories in low Earth orbit in which American, Russian, Canadian, European, and Japanese astronauts are conducting unique scientific and technological investigations in a microgravity environment.

Payload Utilization and Operations Program is the "one-stop shopping provider" for all customer carrier needs and requirements for safe and cost effective access to space via the Space Shuttle.

Investment and Support—The Rocket Propulsion Test Support activity will continue to ensure NASA's rocket propulsion test capabilities are properly managed and maintained in world class condition.

Space Science seeks to chart the evolution of the universe, from origins to destiny, and to understand its galaxies, stars, planetary bodies, and life.

Biological and Physical Research affirms NASA's commitment to the essential role biology will play in the 21st century, and supports the high-priority biological and physical sciences research needed to achieve Agency strategic objectives.

Earth Science develops a scientific understanding of the Earth system and its response to natural and human-induced changes to enable improved prediction of climate, weather, and natural hazards for present and future generations.

Aerospace Technology works to advance U.S. preeminence in aerospace research and technology and to radically improve air travel, making it safer, faster, and quieter, as well as more affordable, accessible, and environmentally sound.

Advanced Space Transportation will create a safe, affordable highway through the air and into space by improving safety, reliability, and operability, while significantly reducing the cost of space transportation systems.

Education (formerly Academic Programs) consists of two components, the Educational Program and the Minority University Program. Together, these components of the Academic Programs provide guidance for the Agency's interaction with both the formal and informal education community.

Space Shuttle is a partially reusable space vehicle that provides several unique capabilities to the U.S. space program. These include retrieving payloads from orbit for reuse; servicing and repairing satellites in space; safely transporting humans to and from space; launching Station components and providing an assembly platform in space; and operation and returning space laboratories.

Space Communications and Data Services supports NASA's Enterprises and external customers with Space Communications and Data System services that are responsive to customer needs.

Space Operations' goal is to provide highly reliable and cost-effective space operations services in support of NASA's science and aeronautics programs.

Commercial Technology Program facilitates the transfer of NASA inventions, innovations, discoveries, or improvements developed by NASA personnel or in partnership with industry/universities to the private sector.

U.S./Russian Cooperative Program includes all flight activities in support of the joint space missions involving the Space Shuttle and the Russian *Mir* Space Station.

**National Aeronautics and Space Administration
Required Supplementary Stewardship Information
Stewardship Investments: Research and Development, Continued
For the Fiscal Years Ended September 30**

Enterprise/Program/Application Descriptions, Continued

Safety, Reliability, and Quality Assurance invests in the safety and success of NASA missions by assuring that sound and robust policies, processes, and tools for safety, reliability, quality assurance, and engineering disciplines are in place and applied throughout NASA.

The **Mission Communication Services Program**, one part of NASA's Space Communications Program, provides support to the breadth of NASA missions, including planetary and interplanetary missions; Human Space Flight missions; near-Earth-orbiting and spacecraft missions; and suborbital and aeronautical test flight systems.

The **Planetary Exploration Program** encompasses the scientific exploration of the solar system including the planets and their satellites, comets, and asteroids.

Other Programs includes the mission of the Office of Inspector General and programs not directly supportive of a single Enterprise.

National Aeronautics and Space Administration
 Required Supplementary Information
 Combined Statement of Budgetary Resources
 For Fiscal Year Ended September 30, 2005
 (In Thousands of Dollars)

	Exploration, Science, and Aeronautics	Exploration Capabilities	Office of Inspector General	Other	Total
Budgetary Resources					
Budgetary Authority					
Appropriation Received	\$ 7,742,550	\$ 8,551,850	\$ 31,600	\$ (11,030)	\$ 16,314,970
Net Transfers, Current Year Authority	196,574	(196,574)	—	—	—
Total Adjusted Appropriations Received	\$ 7,939,124	\$ 8,355,276	\$ 31,600	\$ (11,030)	\$ 16,314,970
Unobligated Balance					
Beginning of Period Anticipated Transfer Balances	\$ 1,202,964	\$ 560,912	\$ 2,601	\$ 1,335,681	\$ 3,102,158
Spending From Offsetting Collections					
Earned					
Collected	\$ 475,567	\$ 337,668	\$ —	\$ 38,073	\$ 851,308
Receivable From Federal Sources	24,768	7,852	50	(11,414)	21,256
Change in Unfilled Orders					
Advance Received	907	14,527	—	(5,425)	10,009
Without Advance From Federal Sources	26,029	107,481	—	(16,154)	117,356
Recoveries of Prior Year Obligations, Actual	\$ —	\$ —	\$ —	\$ 9,721	\$ 9,721
Permanently Not Available					
Cancellations of Expired/ No-Year Accounts	\$ —	\$ —	\$ (764)	\$ (60,202)	\$ (60,966)
Authority Unavailable Pursuant to Public Law	(61,940)	(67,407)	(253)	—	(129,600)
Total Budgetary Resources	\$ 9,607,419	\$ 9,316,309	\$ 33,234	\$ 1,279,250	\$ 20,236,212

National Aeronautics and Space Administration
Required Supplementary Information
Combined Statement of Budgetary Resources, Continued
For Fiscal Year Ended September 30, 2005
(In Thousands of Dollars)

	Exploration, Science, and Aeronautics	Exploration Capabilities	Office of Inspector General	Other	Total
Status of Budgetary Resources					
Obligations Incurred (Note 13)					
Direct	\$ 7,816,840	\$ 8,087,848	\$ 29,234	\$ 1,045,105	\$ 16,979,027
Reimbursable	545,699	388,525	50	84,318	1,018,592
Total Obligations Incurred	\$ 8,362,539	\$ 8,476,373	\$ 29,284	\$ 1,129,423	\$ 17,997,619
Unobligated Balance					
Apportioned, Currently Available	\$ 1,270,021	\$ 770,818	\$ 1,786	\$ 31,150	\$ 2,073,775
Trust Funds	—	—	—	3,523	3,523
Not Available, Other	(25,141)	69,118	2,164	115,154	161,295
Total Unobligated Balances	\$ 1,244,880	\$ 839,936	\$ 3,950	\$ 149,827	\$ 2,238,593
Status Budgetary Resources	\$ 9,607,419	\$ 9,316,309	\$ 33,234	\$ 1,279,250	\$ 20,236,212
Obligated Balance, Net as of October 1	\$ 2,566,808	\$ 1,687,471	\$ 4,255	\$ 300,688	\$ 4,559,222
Obligated Balance, End of Period					
Accounts Receivable	\$ (67,424)	\$ (48,088)	\$ (50)	\$ (24,527)	\$ (140,089)
Unfilled Customer Orders	(281,400)	(143,315)	—	13,257	(411,458)
Undelivered Orders	2,862,029	1,181,620	3,931	316,534	4,364,114
Accounts Payable	932,328	963,022	1,732	226,881	2,123,963
Outlays					
Disbursements	\$ 7,433,017	\$ 8,095,272	\$ 27,876	\$ 915,813	\$ 16,471,978
Collections	(476,475)	(352,194)	—	(32,648)	(861,317)
Subtotal	\$ 6,956,542	\$ 7,743,078	\$ 27,876	\$ 883,165	\$ 15,610,661
Less: Offsetting Receipts	—	—	—	—	—
Net Outlays	\$ 6,956,542	\$ 7,743,078	\$ 27,876	\$ 883,165	\$ 15,610,661

National Aeronautics and Space Administration
Required Supplementary Information
Combined Schedules of Budgetary Resources
For Fiscal Year Ended September 30, 2004
(In Thousands of Dollars)

Current year activity (opening balances) is required to prepare the required supplementary information for the combined statement of budgetary resources and this information was not available in FY 2004.

National Aeronautics and Space Administration
 Required Supplementary Information
 Intragovernmental Transactions
 For the Fiscal Year Ended September 30, 2005
 (In Thousands of Dollars)

Intragovernmental Assets

Agency	Fund Balance With Treasury	Investments	Accounts Receivable	Advances and Prepaid Expenses
Treasury	\$ 8,145,941	\$ 17,262	\$ 74	\$ —
Air Force	—	—	60,616	—
Army	—	—	11,596	—
Commerce	—	—	39,458	—
Navy	—	—	10,336	—
National Science Foundation	—	—	85	—
Secretary of Defense	—	—	4,532	—
Transportation	—	—	5,329	—
Other	—	—	3,837	—
Total	\$ 8,145,941	\$ 17,262	\$ 135,863	\$ —

Intragovernmental Liabilities

Agency	Accounts Payable	Closed Accounts Payable	Workers' Compensation	Liability for Deposit and Clearing Funds
Air Force	\$ 20,235	\$ 882	\$ —	\$ 320
Army	954	50	—	—
Commerce	(4,830)	390	—	(33)
Energy	11,571	76	—	(369)
Labor	46	—	15,211	—
Navy	2,067	53	—	(1,805)
Interior	(2,244)	23	—	—
National Science Foundation	629	1	—	—
Secretary of Defense	7,637	—	—	(7,985)
Treasury	79	—	—	—
Transportation	218	—	—	(586)
Other	17,345	622	—	10,073
Total	\$ 53,707	\$ 2,097	\$ 15,211	\$ (385)

National Aeronautics and Space Administration
Required Supplementary Information
Intragovernmental Transactions, Continued
For the Fiscal Year Ended September 30, 2005
(In Thousands of Dollars)

Intragovernmental Liabilities, Continued

Agency	Advances From Others	Other Liabilities	Employer Contributions and Payroll Taxes	Custodial Liability
Air Force	\$ 49,666	\$ —	\$ —	\$ 107
Army	21,601	—	—	—
Commerce	8,852	—	—	—
Energy	214	—	—	—
Office of Personnel Management	—	—	10,482	—
Interior	20	—	—	—
National Science Foundation	36	—	—	6
Navy	2,185	—	—	18
Secretary of Defense	7,536	—	—	—
Transportation	2,701	—	—	41
Treasury	56	—	—	—
Veterans Affairs	3,182	—	—	—
Other	3,272	(5,397)	—	5,287
Total	\$ 99,321	\$ (5,397)	\$ 10,482	\$ 5,459

Agency	Intragovernmental Revenue	Intragovernmental Expense
Air Force	\$ 361,841	\$ 138,771
Army	34,392	66,142
Commerce	286,472	21,104
Energy	2,261	136,116
Environmental Protection Agency	2,105	155
National Science Foundation	1,008	12,330
Navy	42,484	55,188
Secretary of Defense	28,998	98,753
Transportation	15,976	21,123
Treasury	257	1,563
Interior	2,649	19,379
Agriculture	4,816	3,266
Veterans Affairs	1,266	601
Other	6,182	583,436
Total	\$ 790,707	\$ 1,157,927

National Aeronautics and Space Administration
 Required Supplementary Information
 Intragovernmental Transactions, Continued
 For the Fiscal Year Ended September 30, 2004
 (In Thousands of Dollars)

Intragovernmental Assets

Agency	Fund Balance With Treasury	Investments	Accounts Receivable	Advances and Prepaid Expenses
Treasury	\$ 7,629,298	\$ 17,077	\$ 69	\$ —
Air Force	—	—	53,431	—
Army	—	—	9,046	—
Commerce	—	—	25,569	—
Navy	—	—	9,868	—
National Science Foundation	—	—	177	—
Secretary of Defense	—	—	5,521	—
Transportation	—	—	5,264	—
Other	—	—	7,420	—
Total	\$ 7,629,298	\$ 17,077	\$ 116,365	\$ —

Intragovernmental Liabilities

Agency	Accounts Payable	Closed Accounts Payable	Workers' Compensation	Liability for Deposit and Clearing Funds
Air Force	\$ 23,117	\$ 75	\$ —	\$ —
Army	489	(477)	—	—
Commerce	258	242	—	—
Energy	13,550	(12)	—	—
Labor	32	—	15,787	—
Navy	3,876	(1)	—	—
Interior	—	—	—	—
National Science Foundation	2,488	—	—	—
Secretary of Defense	6,571	10	—	—
Treasury	525	—	—	—
Transportation	(1,111)	—	—	—
Other	20,188	4,152	—	781
Total	\$ 69,983	\$ 3,989	\$ 15,787	\$ 781

National Aeronautics and Space Administration
Required Supplementary Information
Intragovernmental Transactions, Continued
For the Fiscal Year Ended September 30, 2004
(In Thousands of Dollars)

Intragovernmental Liabilities, Continued

Agency	Advances From Others	Other Liabilities	Employer Contributions and Payroll Taxes	Custodial Liability
Air Force	\$ 45,703	\$ —	\$ —	\$ —
Army	17,004	—	—	—
Commerce	8,246	—	—	—
Energy	192	—	—	—
Office of Personnel Management	—	—	440	—
Interior	—	—	—	—
National Science Foundation	3	—	—	—
Navy	1,563	—	—	—
Secretary of Defense	6,178	—	—	—
Transportation	5,021	—	—	—
Treasury	9	—	—	—
Veterans Affairs	4,737	—	—	—
Other	1,912	1,214	—	2,082
Total	\$ 90,568	\$ 1,214	\$ 440	\$ 2,082

Agency	Intragovernmental Revenue	Intragovernmental Expense
Air Force	\$ 248,641	\$ 133,668
Army	45,515	41,111
Commerce	209,911	16,540
Energy	2,415	125,409
Environmental Protection Agency	1,552	262
National Science Foundation	1,031	12,515
Navy	51,570	35,633
Secretary of Defense	45,304	88,567
Transportation	17,874	17,649
Treasury	221	2,765
Interior	2,906	21,329
Agriculture	4,879	3,756
Veterans Affairs	932	282
Other	(15,766)	556,989
Total	\$ 616,985	\$ 1,056,475

**National Aeronautics and Space Administration
 Required Supplementary Information
 Deferred Maintenance
 For the Fiscal Year Ended September 30, 2005**

NASA has deferred maintenance only on its facilities, including structures. There is no significant deferred maintenance on other physical property, such as land, equipment, assets in space, leasehold improvements, or assets under capital lease. Contractor-held property is subject to the same considerations.

NASA developed a Deferred Maintenance parametric estimating method (DM method) in order to conduct a consistent condition assessment of its facilities. This method was developed to measure NASA's current real property asset condition and to document real property deterioration. The DM method produces both a parametric cost estimate of deferred maintenance, and a Facility Condition Index. Both measures are indicators of the overall condition of NASA's facility assets. The DM method is designed for application to a large population of facilities; results are not necessarily applicable for individual facilities or small populations of facilities. Under this methodology, NASA defines acceptable operating condition in accordance with standards comparable to those used in private industry, including the aerospace industry.

While there have been no significant changes in our deferred maintenance parametric estimating method this year, an increase in repairs/renewal of funds associated with the Return to Flight program and hurricane damage repairs to the Vehicle Assembly Building at Kennedy Space Center had a significant impact on the FY 2005 deferred maintenance and facility condition assessment.

Deferred maintenance related to heritage assets is included in the deferred maintenance for general facilities. Maintenance is not deferred on active assets that require immediate repair to restore them to safe working condition and have an Office of Safety and Mission Assurance Risk Assessment Classification Code 1 (see NASA STD 8719.7 in the NASA Facility Systems Safety Guide Book).

	<u>2005</u>	<u>2004</u>
Deferred Maintenance Method		
Facility Condition Index (FCI)	3.7	3.7
Target Facility Condition Index	4.3	4.3
Backing of Maintenance/Repair Est. Active and Inactive Facilities (in billions)	\$ 2.3	\$ 1.67



November 14, 2005

TO: Administrator
Chief Financial Officer

FROM: Inspector General

SUBJECT: Audit of the National Aeronautics and Space Administration's
Fiscal Year 2005 Financial Statements

Under the Chief Financial Officers Act of 1990, NASA's financial statements are to be audited in accordance with generally accepted government auditing standards. The Office of Inspector General selected the independent certified public accounting firm Ernst & Young LLP (E&Y) to audit NASA's financial statements in accordance with *Government Auditing Standards* and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as amended.

In the enclosed *Report of Independent Auditors*, E&Y disclaimed an opinion on NASA's financial statements for the fiscal year ended September 30, 2005. The disclaimer resulted from NASA's inability to provide E&Y auditable financial statements and sufficient evidence to support the financial statements throughout the fiscal year and at year-end.

The E&Y *Report on Internal Control* includes four reportable conditions of which three are considered to be material weaknesses. Material weaknesses were found in NASA's controls for: (1) financial systems, analyses and oversight used to prepare the financial statements, (2) reconciling differences in the Fund Balance with Treasury, and (3) assuring that property, plant, and equipment and materials are presented fairly in the financial statements. The final reportable condition concerns weaknesses in NASA's controls for estimating environmental liability.

The E&Y *Report on Compliance with Laws and Regulations* identifies several instances in which NASA's financial management systems did not substantially comply with *Federal Financial Management Improvement Act of 1996 (FFMIA)* requirements. For example, the report notes that certain subsidiary systems, including property, are not integrated with the Core Financial module. E&Y is also reporting that, based on a referral from the OMB, my office is currently evaluating whether NASA has violated certain provisions of the Anti-Deficiency Act. This referral principally relates to whether obligations exceeded funds as apportioned by OMB.

NASA made significant progress in FY 2005 correcting control weaknesses related to securing the computing environment that supports the Integrated Enterprise Management Program. However, NASA's continued problems in resolving its other internal control

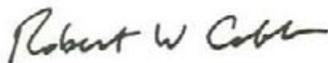
weaknesses have contributed to its inability to produce complete and accurate financial statements. Many of NASA's internal control deficiencies are material weaknesses that have been reported for several years. The Agency has not been able to articulate with clarity comprehensive action plans for how it will address these internal control weaknesses.

To address the weaknesses that E&Y reported, NASA should develop corrective action plans that are fully coordinated with NASA program and institutional leadership and within parameters set by financial management and accounting laws and regulations. The plans must be detailed enough to ensure successful implementation with desired results. In addition, NASA must continue to:

- Ensure that the Chief Financial Officer's Office is staffed to address the Agency's financial management and accountability challenges.
- Ensure that accounting practices are consistent with applicable standards and are consistently applied.
- Establish internal controls that provide reasonable assurance that the financial statements are supported, complete, and accurate.
- Identify and correct data conversion and integrity problems in the Core Financial module.
- Implement recommendations made in E&Y's *Report on Internal Control*, and those made by our office and the Government Accountability Office.

E&Y is responsible for each of the enclosed reports and the conclusions expressed therein. Accordingly, we do not express an opinion on NASA's financial statements, internal controls over financial reporting, or compliance with certain laws and regulations including, but not limited to, FFMIA.

In fulfilling our responsibilities under the Chief Financial Officers Act of 1990, we provided oversight and technical support. We monitored the progress of the audit, reviewed reports submitted by E&Y, and ensured that they met contractual requirements.



Robert W. Cobb

3 Enclosures

Report of Independent Auditors

To the Administrator and the Office of Inspector General
of the National Aeronautics and Space Administration

We were engaged to audit the accompanying consolidated balance sheets of the National Aeronautics and Space Administration (NASA) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position and financing and combined statements of budgetary resources for the fiscal years then ended. These financial statements are the responsibility of NASA's management.

During fiscal year (FY) 2003, NASA implemented an Integrated Financial Management Program (IFMP) system (now referred to as the Integrated Enterprise Management Program (IEMP) system), specifically the Core Financial Module. NASA's management identified significant errors beginning with its September 30, 2003 financial statements resulting from the implementation of IEMP. During FY 2004 and FY 2005, NASA's management continued to identify and resolve significant system conversion and data integrity issues, implement internal control, and develop policies and procedures. Additionally, NASA's management indicated that throughout much of the period, the Core Financial Module could not link manual adjustments/corrections to the original transaction. Further, in FY 2004 and FY 2005 NASA was unable to provide a subsidiary listing of outstanding balances to support certain financial statement balances, including accounts payable and undelivered orders, and NASA's management was unable to represent that its financial statements were fairly stated. Late in FY 2005, internal control and financial reporting processes using the Core Financial Module were continuing to evolve, including development of routine account analysis and reconciliation processes and analysis of the basis of accounting for property, plant, and equipment. As a result of these limitations, we were unable to obtain sufficient evidential support for the amounts presented in the consolidated balance sheets as of September 30, 2005 and 2004, and the related consolidated statements of net costs, changes in net position and financing and combined statements of budgetary resources for the fiscal years then ended.

Because of the matters discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheets as of September 30, 2005 and 2004, and the related consolidated statements of net cost, statements of changes in net position and financing, and combined statements of budgetary resources for the fiscal years then ended.



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In its preparation and analysis of its September 30, 2005 and 2004 financial statements, NASA's management identified certain configuration and data integrity issues and significant errors in balances reported on its financial statements. The footnotes to the financial statements describe certain departures or potential departures from accounting principles generally accepted in the United States of America in NASA's FY 2005 and FY 2004 financial statements and a potential adjustment for certain mission-related assets (theme assets) that, if recorded, could have a significant impact on the financial statements.

The information presented in the Management's Discussion and Analysis (MD&A), Required Supplementary Stewardship Information, and the Required Supplementary Information is not a required part of the NASA's financial statements but is considered supplementary information required by Office of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. Such information has not been subjected to auditing procedures, and accordingly, we express no opinion on it. We were unable to apply to the information certain procedures prescribed by professional standards within the time frames established by OMB because of the limitations on the scope of our audit of the financial statements discussed above. Additionally, we were unable to assess control risk relevant to NASA's intra-governmental transactions and balances, as required by OMB Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, because reconciliations were not performed with certain federal trading partners as required by OMB Circular A-136. Finally, programs identified in the financial statements do not directly align with the major goals and outputs described in the MD&A.

In accordance with *Government Auditing Standards*, we have also issued our reports dated November 4, 2005, on our consideration of NASA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our work.

November 4, 2005
Washington, D.C.

Report on Internal Control

To the Administrator and the Office of Inspector General
of the National Aeronautics and Space Administration

We were engaged to audit the financial statements of the National Aeronautics and Space Administration (NASA) as of and for the year ended September 30, 2005, and have issued our report thereon dated November 4, 2005. The report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheet as of September 30, 2005, and the related consolidated statements of net cost, changes in net position and financing and combined statement of budgetary resources for the fiscal year then ended.

In planning and performing our work, we considered NASA's internal control over financial reporting in order to determine our procedures for the purpose of expressing an opinion on the financial statements, which we were ultimately not able to do, and not to provide an opinion on the internal control over financial reporting. We limited our internal control testing to those controls necessary to achieve the objectives described in OMB Bulletin No. 01-02 *Audit Requirements for Federal Financial Statements*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982 (FMFIA), such as those controls relevant to ensuring efficient operations. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect NASA's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions we noted are described below.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider the first three matters noted—Financial Systems, Analyses, and Oversight; Further Research Required to Resolve Fund Balance with Treasury Differences; and Enhancements Needed for Controls Over Property, Plant, and Equipment and Materials—to be material weaknesses.



MATERIAL WEAKNESSES

Financial Systems, Analyses, and Oversight (Modified Repeat Condition)

Overview

OMB Circular A-127 requires that financial statements be the culmination of a systematic accounting process. The statements are to result from an accounting system that is an integral part of a total financial management system containing sufficient structure, effective internal control, and reliable data. In fiscal year (FY) 2002, NASA initiated a seven-year agency-wide effort to provide a single, integrated suite of financial, project, contract, and human capital tools to help manage NASA's programs and prepare financial information on a timely basis consistent with evolving OMB guidance. During FY 2003, NASA implemented an Integrated Financial Management Program (IFMP) system (now referred to as the Integrated Enterprise Management Program (IEMP) system), specifically the Core Financial Module. The Core Financial Module replaced ten disparate center-level accounting systems and the NASA headquarters accounting system, along with approximately 120 ancillary subsystems in operations for the past two decades. This conversion effort necessitated complex, extensive data cleanup, which was not always successfully completed.

NASA has positioned itself for further improvement by eliminating the disparate systems at the centers and moving to a single platform. NASA is also processing transactions in the system with a frequent theme of IEMP supporters being that contractors and employees are being paid, and the business of NASA is being conducted. Pending further improvements, NASA's inability to demonstrate sound financial management, inadequate internal controls, and failure to support periodic financial reporting of reliable data severely impacts the credibility of the agency's reports to oversight entities and the support provided its managers and employees in executing their responsibilities.

NASA's management identified significant errors beginning with its September 30, 2003 financial statements resulting from the implementation of the IEMP system. During FY 2004 and FY 2005, NASA's management continued to identify and resolve significant system conversion and data integrity issues, implement internal control, and develop policies and procedures. In its preparation and analysis of its quarterly financial statements throughout the year, including the September 30, 2005 financial statements, NASA's management continued to identify and resolve system configuration and data integrity issues and errors in balances reported on its financial statements. In its explanations to adjustments to NASA's financial statements for the first three quarters, NASA's Office of the Chief Financial Officer (OCFO) disclosed among other items:

- The financial management system is not currently designed to distinguish between current transactions and corrections to prior year transactions posted in the current year.

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- Functionality and configuration problems in IEMP created inappropriate transactional postings, which resulted in abnormal balances and misstatement of unobligated and other balances.
- The financial system as currently configured is unable to properly record recovery of prior year obligations.
- The configuration and data integrity issues from FY 2003 and FY 2004 continue to cause misstatements in accounts that contain trading partner data. This has limited NASA's ability to reconcile and resolve differences with trading partners and to eliminate intra-entity transactions.
- Data anomalies and abnormalities caused misstatements in many budgetary and proprietary accounts, potentially causing FY 2005 financial statement data to be inaccurate or incomplete.

An indeterminable amount of activity to adjust prior year errors are reflected in the NASA financial statements as current year activity. NASA's management indicated that the Core Financial Module could not provide an audit trail for certain transactions and that processes to develop appropriate reports, including subsidiary ledgers, were ongoing.

NASA continues to work toward resolving issues noted in the FY 2004 financial statement audit report related to the lack of an integrated financial management system and inadequate financial accounting and supervisory review processes. For example, certain actions we noted include:

- Financial Statement Preparation. We noted improvement in the financial statement preparation process, including the implementation of detailed analysis and quality control functions. The process was an area of emphasis, with incremental improvements noted each quarter, culminating in statements prepared from the Core Financial Module at year-end, with many adjustments made inside the system prior to preparation of the financial statements. In addition, the financial statement preparation process was also improved through the publication of financial management procedures.
- Policies and Procedures. At the end of FY 2004, NASA published eight volumes of the new NASA Financial Management Requirements (FMR), and during FY 2005, NASA published five additional volumes. These volumes include: Internal Management Controls, Travel, and Special Accounts, issued in April 2005; Periodic Monitoring Control Activities, issued in August 2005; and Cash Management, issued in September 2005. In addition, in May 2005, NASA issued Fund Balance with Treasury Reconciliation procedures, which is referred to in the volume on Periodic Monitoring



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Controls, but not yet issued as a separate FMR volume. Although we noted progress in the development of the FMRs, due to the limited extent of our testing, we were unable to conclude on the quality, completeness, and accuracy of the FMRs.

- **Data Integrity and Monitoring Efforts.** In the last half of FY 2005, NASA began a process to develop a monitoring function and to augment center personnel data integrity efforts with supplemental staffing and focused visits from headquarters and contractor personnel.
- **Property.** We noted progress in the development of the FMRs and the promulgation of standardized policies and procedures surrounding property, plant, and equipment; however, our internal control testing over certain property areas illustrated inconsistencies in the execution of those policies by the centers. For example, we found a lack of supporting evidential documentation and written authorization for certain FY 2005 transactions, which are fundamental control policies noted in the FMR. In addition to publishing property, plant, and equipment policy in the NASA FMR document in September 2004, NASA informed us that major contracts were amended to require monthly reporting of property values into a Web-enabled database. Process improvements in valuation practices, information systems to align the technical and financial work breakdown structures into a single data-management structure to promote consistency, and increased oversight by NASA and outside reviewers are included in ongoing efforts to improve reporting by contractors.
- **Fund Balance with Treasury.** NASA continues to make progress in resolving its fund balance with Treasury imbalance. While not completely reconciled, major differences identified in the FY 2004 financial statement audit have been researched, and we were informed that many have been corrected. Corrective actions will continue into FY 2006 to demonstrate how prior reconciling items have been cleared and to resolve the current unreconciled balance. One of these actions included recent implementation of policies and procedures for consistent reconciliation processes at the centers.

Although progress was made, significant financial management issues continue to impair NASA's ability to accumulate, analyze, and distribute reliable financial information. Our review of the internal control continued to disclose numerous weaknesses in NASA's ability to report accurate financial information on a timely basis. We continue to note that NASA's Core Financial Module lacks integration with certain subsidiary systems and contains insufficient internal control to detect and support the correction of invalid entries in a timely fashion. Additionally, NASA personnel were not consistently utilizing uniform accounting processes that record, classify, and summarize information for the preparation of financial statements. An integrated financial system, a sufficient number of properly trained personnel, and a strong oversight function are needed to ensure that periodic analyses and reconciliations are completed to detect and resolve errors and irregularities in a timely manner. These processes were being

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developed in FY 2005, with multiple teams assigned to reviewing output from the Core Financial Module and performing edit and reasonableness checks and other analysis in the last half of the year.

Lack of an Integrated Financial Management System

The NASA financial management systems are not compliant with the Federal Financial Management Improvement Act of 1996 (FFMIA). FFMIA requires agencies to implement and maintain financial management systems that comply with federal financial management systems requirements as defined by the former Joint Financial Management Improvement Program (JFMIP). More specifically, FFMIA requires federal agencies to have an integrated financial management system that provides effective and efficient interrelationships between software, hardware, personnel, procedures, controls, and data contained within the systems. The lack of an integrated financial management system continues to impair NASA's and the centers' abilities to adequately support and analyze account balances reported.

Although NASA implemented a commercial off-the-shelf financial module approved by the former JFMIP, certain aspects of the NASA accounting system lack integration and do not conform to the requirements. NASA's management continues to identify data integrity and configuration issues in the Core Financial Module that result in inappropriate transactional postings. Additionally, NASA remains unable to design reports from the Core Financial Module that comprise detailed listings of balances to support NASA's September 30, 2005 reported balances. Finally, certain subsidiary systems, including systems used to account for property, plant, and equipment, the largest NASA asset, are not integrated with the Core Financial Module. Specific weaknesses noted include the following:

- During our FY 2004 audit, we were unable to obtain a listing of balances from the Core Financial Module for specific balance sheet accounts, or for cash receipts and cash disbursements to support budgetary outlays during the fiscal year. During FY 2005, the OCFO worked with the Competency Center to design subsidiary reports that should not only be used for audit purposes, but by the OCFO as a routine management tool to ensure analysis, research, and resolution occurs for various account activities and balances. Although the subsidiary reports we received as of June 30, 2005 agreed to general ledger amounts, we noted during our testing that items in the subsidiary reports for balance sheet accounts were transactional-based instead of balance-based. As a result, we had to redesign our testing procedures to recreate account balances. In addition, although the downloads we received for FY 2005 cash receipts and cash disbursements agreed to current Treasury reports, we noted during our testing that many of the items selected represented prior year transactions or adjustments. Because such items are not uniquely identified in the Core Financial Module, we were unable to readily access a population of FY 2005 activity.



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Currently, the centers are able to provide certain subsidiary listings; however, the listings are frequently being generated from non-routine processes, not directly from the Core Financial Module. However, although the centers use these reports for management oversight purposes, such as aging analyses and collection initiatives, we noted during our testing that several of our sample items for accounts receivable were related to balances that were greater than one year old.

- As noted earlier, the Core Financial Module does not provide for tracking manual non-routine or correction entries with linkage back to the original transaction or the capability to isolate manual adjustments. As a result, adjustments and corrections cannot be readily identified. During FY 2005, NASA began using a separate package, NASA Audit Tracking System (NATS), to track certain NASA-wide adjustments and related support – for management oversight as well as for audit purposes. Although this is a step in the right direction, it is not the solution. Not all adjustments are posted in NATS, and once ultimately posted in IEMP, corrections and adjustments are still not readily identified, and there is not a process to ensure the adjustments are entered into the system correctly.
- Certain subsidiary systems, including all property systems (i.e., NEMS, NRPDB, and CHATS), are not integrated with the Core Financial Module.
- NASA's management continued to identify certain transactions that are being posted incorrectly due to improper configuration within the Core Financial Module. For example, in its year-end fluctuation analysis provided with the September 30, 2005 financial statements, NASA indicated that the difference between FY 2004 and FY 2005 amounts for other liabilities was due to incorrect configuration for closing rules for a specific general ledger account, which had been corrected by various NASA centers. NASA further indicated that mispostings caused out-of-balance conditions in payables and budgetary to proprietary reconciliations.
- Due to systematic limitations, NASA centers continue to use alternative approaches to ensure data and financial management information is readily available to make critical decisions. These alternative approaches are inconsistent between centers and may cause varied results in the accuracy of reporting from the centers to headquarters. For example, during our center visits, we noted that some centers use manually created spreadsheets to track invoice due dates to ensure compliance with Prompt Payment Act requirements. However, we noted that other centers rely on IEMP to track the payment due dates for compliance.

Further, several access and segregation of duties issues were noted within the IEMP environment. The level of risk associated with these information technology issues depends in part upon the extent to which financial-related compensating controls (such as reconciliations and robust reviews of output) are in place and operating effectively during the audit period.

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Certain of these controls designed to detect errors or inappropriate processing may also not be executed in a manner which can be expected to identify errors, which, while perhaps not material to the financial statements as a whole, may subject NASA to risks regarding safeguarding of assets. Within the context of the overall weaknesses identified in the control environment referenced in the accompanying comments, although NASA has made progress in addressing and resolving prior year information technology findings, these information technology-related issues merit continued management focus.

Financial Statement Preparation and Analysis

During our FY 2004 audit, we noted that because of system conversion issues and the pervasiveness of errors identified in the Core Financial Module, financial statement amounts were found to be unreliable and not complete. For purposes of preparing the first three quarter financial statements during FY 2005, NASA made the decision to utilize estimates or adjustments to IEMP data in preparing its financial reporting to OMB and Treasury because financial statements generated from the Core Financial Module were deemed unreliable. The estimates were based on Treasury reports, FY 2004 balances, and/or budgetary or planned outcomes. Our review of the June 30, 2005 interim financial statements generated by the Core Financial Module identified the following:

- Although the amount is not material, the third quarter balance sheet generated from the Core Financial Module did not balance, meaning that assets did not agree to liabilities plus net position. Adjustments were made outside the system to correct this prior to submission of the quarterly statements to OMB.
- IEMP functionality created inappropriate transaction postings in some account balances. For example, NASA noted in its third quarter explanation for adjustments that some invalid accounts payable balances were noted in some canceled appropriations.
- Unexpended appropriations were decreased by \$1.157 billion. In its adjustment explanation, NASA noted that the adjustment was required to align the FY 2005 opening balance in IEMP to the amount reported on the financial statements as an ending balance in FY 2004. NASA also stated in its explanation that the financial management system is not currently designed to distinguish between current transactions and corrections to prior year transactions posted in the current year. NASA is exploring alternatives to develop a process and system design which would allow for distinguishing between current transactions and corrections to prior year transactions posted in the current year. In addition, NASA indicated that it is reconciling and verifying legacy closing balances to the opening balances in IEMP, and that the effort will assist in resolving the FY 2005 opening balance differences. NASA further explained in this adjustment that the opening balances in IEMP are also impacted by the special-purpose ledger repost activities which are used to resolve incorrect configuration postings. As the adjustment is posted, the



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original transaction is reversed and, when executed, causes beginning balances in some accounts to change as the adjustment is posted to adjust the original transaction in the original period.

The pervasiveness of these and other errors made it impractical for us to perform significant substantive audit procedures on NASA's June 30, 2005, financial statements.

Although NASA generated its financial statements from the Core Financial Module at September 30, 2005, NASA's management continued to identify similar issues during FY 2005. Additionally, the data integrity issues identified during FY 2003 continued to impair FY 2005 balances. Finally, NASA continued to identify functionality and configuration issues that impaired its ability to prepare accurate and complete financial statements. For example, in our review of the September 30, 2005 financial statements, we continued to note the following concerns:

- During our testing, we continued to identify situations where costs are not recorded properly. NASA designed its new Core Financial Module to include a system edit whereby, if costs (and the corresponding liabilities) are greater than the associated obligations, the difference would not be recorded in NASA's general ledger but rather maintained outside of the general ledger system. Instead, the differences were adjusted at the contract/project level by posting a liability to match the excess costs. Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, SFFAS No. 4, *Managerial Cost Accounting Concepts & Standards*, and NASA's FMRs require costs to be accrued in the period in which they are incurred and any corresponding liability to be recorded as an account payable, regardless of the associated amounts obligated.
- The Core Financial Module was still unable to provide a breakdown of costs by the four mission directorates which NASA has identified as significant segments. This is not consistent with the requirements of SFFAS No. 4, which calls for presentation of costs by responsibility segment.
- Although the first three quarters did not directly crosswalk to the final adjusted financial statements that were ultimately submitted to OMB, the year-end statements were generated directly from the Core Financial Module. However, we noted that many adjustments were posted in the system to arrive at the final balances that crosswalked to the financial statements.

Additional Controls Need to be Strengthened

The U.S. Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* states that internal control activities help ensure that management's directives are carried out. The control activities should be effective and efficient in accomplishing the organization's control objectives. Examples of control activities include top-level reviews, reviews by management at the functional or activity level, segregation of duties, proper execution of transactions and events, accurate and timely recording of transactions and events, and appropriate documentation of transactions and internal control.

Because significant weaknesses exist in the Core Financial Module, management must compensate for the weaknesses by implementing and strengthening additional controls that will ensure errors and irregularities are detected in a timely manner. The weaknesses identified impact NASA's ability to report accurate financial information. During FY 2005, we found that certain processes were not adequately performed to ensure differences were properly identified, researched, and resolved in a timely manner and that account balances were complete and accurate. The following represents specific areas that need enhanced periodic reconciliation and analysis procedures:

- **Manual or Non-Routine Transactions.** The Core Financial Module does not provide for tracking of non-routine or correction entries with linkage back to the original transaction. Non-routine transactions are high risk and should be closely monitored. We noted that there was no unique identifier in the system to easily access these transactions. As noted earlier, NASA tracks some, but not all adjustments in NATS. Once posted in IEMP, adjustments or non-routine entries are not always readily identifiable. For example, during our review of adjustment support of the FY 2005 third quarter balance sheet, we noted that the fund balance with Treasury line item was adjusted because the appropriation received amount in IEMP did not agree to the appropriation/Public Law amount. Support for this adjustment was posted in NATS. The posting in IEMP is not readily identified as an adjustment, but would only show at a high level the amount, fund, and general ledger account impacted. Drilling down to the detail in IEMP shows a document reference number which is the support posted in NATS.
- **Documentation.** We noted that adequate documentation to support certain transactions was not readily available. Our testing of transactions identified several items where we did not receive sufficient information to determine if the transaction was valid. For example, as noted in our FY 2004 audit, NASA could not provide documentation to support whether a grant accrual was required to be reported as part of its financial statements as of September 30, 2005. NASA OCFO personnel indicated that the agency is currently working on policies and procedures to establish and maintain an accrual and expects to have this system in place at the end of FY 2006. In addition, NASA could not provide written evidential documentation authorizing the construction and subsequent



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transfer of certain real properties to another entity. Similarly, the Office of Inspector General (OIG) of NASA has been working with OCFO to review documentation related to clearance of a portion of the fund balance with Treasury reconciling items from FY 2003 and has stated that the documentation provided is insufficient.

- **Periodic Report Preparation and Reviews.** NASA remains unable to design and customize reports from the Core Financial Module that comprise detailed listings of balances. Prior to our testing of contracts and grants, we requested separate listings of grants and contracts that were open in FY 2005. After multiple iterations, we received separate listings for grants and contracts that were certified by the centers as being complete. During our testing however, we noted that our sample selections for both grants and contracts contained many items that had previously been closed. In addition, during our visit to one center, we noted a significant backlog of grants where closeout and de-obligations of remaining amounts were pending. For example, we noted during our visit that approximately 3,300 grants from FY 1998 to FY 2005 were awaiting closeout and de-obligations for a total of approximately \$49.3 million. Further, we noted several grant and contract sample items where requested supporting documentation was not in the files.

The GAO's *Standards for Internal Control in the Federal Government* indicates that internal control monitoring should assess the quality of performance over time and ensure that findings of audits and other reviews are promptly resolved. Without appropriate monitoring and oversight of contractor operations, deficiencies in internal control may allow material misstatements to occur without being identified in a timely manner.

Given the severity of these issues, including system and process limitations and expertise needed in the new and future financial reporting requirements, it will take a sustained commitment and a qualified support team to resolve these issues in preparation for FY 2006 and future years.

Recommendation

We recommend that NASA continue to develop and refine its financial management systems and processes to improve its accounting, analysis, and oversight of financial management activity. Specifically, we recommend that NASA:

- Continue to improve its financial reporting and internal quality review procedures to reasonably assure that information presented in the Performance and Accountability Report is accurate and is consistent with the requirements of OMB Circular A-136, *Financial Reporting Requirements*.

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- Configure the Core Financial Module to provide a breakdown of net costs consistent with programs identified in NASA's strategic plan and in the Management's Discussion and Analysis (MD&A) section of the financial statements.
- Ensure that systems used to prepare the financial statements are complete and have been sufficiently tested prior to interim and year-end reporting dates. NASA should continue to validate its data within the Core Financial Module to resolve issues with data integrity that date back to the system conversion in FY 2003 to ensure that data is accurate and complete. In addition, NASA should continue to develop a long-term solution within IEMP to identify, support, and track adjustments made to general ledger accounts.
- Continue to devise short-term and long-term resolutions to IEMP systematic and integration issues and the lack of internal controls surrounding costs in excess of obligations and downward adjustments.
- Formally document roles and responsibilities of its headquarters, IEMP Competency Center, and center financial management personnel across all levels to ensure that appropriate responsibilities are aligned with job functions and that accountability is achieved at each level. Additionally, we recognize that resource limitations may constrain NASA's ability to execute its mission. Management should continue to focus on filling key vacancies within the financial management organization.
- Provide additional "hands-on" training for financial personnel – at headquarter and center levels – to ensure that they understand their roles in processing transactions, performing account analyses and reconciliations, maintaining supporting documentation, and updating their knowledge of financial reporting requirements.
- Develop reports from the Core Financial Module to facilitate reviews and ensure that agings of transactions and open items, unliquidated obligations, grants, and other key areas are periodically assessed, researched, and resolved.

Further Research Required to Resolve Fund Balance with Treasury Differences (Modified Repeat Condition)

An agency's fund balance with Treasury represents monies an agency can spend for authorized transactions, which are based on budget spending authorizations and are made available through Treasury warrants. Amounts available are increased or decreased as monies are collected and disbursed. Although Treasury serves as the central processing facility for federal entities, Treasury does not maintain independent accounting records of each agency's fund balance with Treasury but relies instead on monthly data reported by each agency for its record of agency collections, disbursements, and fund balance with Treasury.



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Throughout FY 2003, NASA implemented, in phases, a commercial off-the-shelf, agency-wide, integrated financial management system that replaced ten separate accounting systems in operation at NASA centers. This effort, which involved converting accounting data in the “legacy” accounting systems to a new accounting system, created complex accounting issues for FY 2003. Consequently, as noted in the FY 2003 audit report, as well as in our FY 2004 audit report, NASA posted year-end adjustments outside its Core Financial Module, which indicated that the difference between its fund balance with Treasury balance and Treasury’s balance was significantly greater than had been presented in its year-end reconciliation. In addition, these adjustments did not provide sufficient documentary evidence to explain the linkage between the adjustments and the unreconciled differences identified on headquarters’ fund balance with Treasury reconciliations as of September 30, 2003.

During FY 2004 and FY 2005, the NASA headquarters and its centers expended much effort analyzing the FY 2003 year-end adjustments to the fund balance with Treasury account and the impact to other related accounts. As a result, NASA classified the transactions into four major categories: document conversion, canceled appropriations, trust fund transfer, and other reconciling items. The correcting adjustments involved analysis of thousands of transactions that were not processed through the new financial system, not coded correctly, or were included erroneously in the new system during the conversion. The work to validate the correction process is ongoing. The OIG has been working with OCFO to review documentation related to clearance of a portion of the cash reconciling items from FY 2003 and has stated that the documentation provided is insufficient.

Although we were informed that many errors from FY 2003 were resolved, significant errors within the accounting system were still being identified by NASA in FY 2005. Fund balance with Treasury reconciliation processes were ineffective in FY 2004 and much of FY 2005, through the date of our visits to centers, but it is our understanding that steps taken by NASA in the last quarter of the year are believed by NASA management to have substantially improved the effectiveness of such reconciliations. Through our discussions with OCFO personnel, they appear to have analyzed the differences by center to determine what differences can be explained and resolved as of September 30, 2005. However, because we had not yet received the subsequent month’s reconciliations prior to the end of our fieldwork, we were unable to determine if these have been resolved.

OCFO identified a net value difference of \$58.9 million between the Core Financial Module and the Treasury balance, where the Core Financial Module balance was greater than the Treasury balance; and an absolute value difference of \$80 million when differences are summarized at the Application of Funds (AOF) level (Treasury symbol). Such differences increase to an absolute value of \$1.1 billion when differences are summarized at the detail level, by center and AOF. In addition, the total amount reported in NASA’s Budget Clearing Account (a suspense account used to temporarily record transactions requiring further research) as of September 30, 2005, was

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\$5.8 million, with an absolute value of \$86.1 million. These amounts may include the data conversion adjustments identified during FY 2003, as well as additional differences that have occurred throughout FY 2004 and FY 2005. These balances will require further research to determine the respective amounts and causes of the timing differences, errors, and resulting resolutions.

One of NASA headquarters' reconciliation steps to understanding these differences includes identifying differences between amounts in the Central Resources Control System (CRCS) and the Core Financial Module, by AOF and center. CRCS is the database used by OCFO for budget control by establishing resource plans for all levels. Each month, Resources Authority Warrants (NF 506) are issued from headquarters to centers and monthly activities are posted to CRCS. NASA personnel indicated differences between CRCS and the Core Financial Module occur because of timing differences on entering funding data and fund allocations in CRCS and the Core Financial Module between headquarters and the centers. NASA uses the Core Financial Module to CRCS difference to account for some of the overall Treasury to the Core Financial Module differences. In FY 2005, however, this difference only accounted for a net \$4.1 million of the \$58.9 million difference.

In May 2005, NASA OCFO issued final policies to the centers for reconciling fund balance with Treasury. The purpose of the procedures is to provide consistent guidance NASA-wide that outlines the requirements for reconciling fund balance with Treasury. It is applicable to each NASA center by Business Area and AOF. During our limited review of procedures in place to comply with the new policy, we noted some progress. In addition, we were also informed that during the last quarter of FY 2005, headquarters OCFO's Office of Quality Assurance conducted on-site quality assistance reviews, including reviews of fund balance with Treasury reconciliations, at all centers. However, we noted that the unreconciled difference shown on the headquarters prepared fund balance with Treasury reconciliation does not agree to the detail shown on the centers' reconciliation. OCFO personnel attributed this difference to receipt type AOFs being shown on the headquarters reconciliation but were not included in the centers' reconciliations. According to OCFO, these receipt type AOFs will be included in the center reconciliations beginning in October 2005. Further, we noted for the NASA agency-wide account (Business Area code 01), NASA headquarters currently does not conduct the same review that the centers perform for the unreconciled fund balance with Treasury differences. OCFO personnel indicated that they are developing a process to enhance the analysis of the data for business area code 01.

Treasury regulations require that each federal entity ensure that it reconciles on a monthly basis its financial records with Treasury's records and that it promptly resolves differences. If this reconciliation is not adequately performed, loss, fraud, and irregularities could occur and not be promptly detected, and/or financial reports that are inaccurate may be prepared and used in decision-making.



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Recommendation

We recommend that NASA continue to improve its current procedures to ensure that all reconciling items are thoroughly researched, timely resolved, and reviewed by appropriate center and headquarters OCFO personnel. In addition, NASA should retain all reports and documentation used in performing its fund balance with Treasury reconciliations to ensure that detailed, documented explanations and resolution actions are maintained for a sufficient audit trail.

Enhancements Needed for Controls Over Property, Plant, and Equipment and Materials (Modified Repeat Condition)

Consistent with prior year audit reports, our review of property, plant, and equipment (PP&E), totaling approximately \$35.0 billion, identified serious weaknesses in internal control that, if not corrected, could prevent material misstatements from being detected and corrected in a timely manner. As stated in the prior year audit report, NASA's current approach to recognizing and accounting for fixed assets relies on reviews of disbursements after they have been made to determine amounts which should be capitalized and is heavily dependent on activities at its contractors to recognize any assets created at its contractors. Currently, NASA expenses all costs and then performs a review of the transactions to determine which costs should be capitalized. The subsequent review and dependence on contractor reporting increases the risk that costs will not be properly capitalized. Until NASA successfully implements a single integrated system for reporting PP&E, and develops a methodology to identify costs that need to be capitalized as the transaction is processed, NASA will continue to experience difficulties in recording property-related balances and transactions. We were informed that certain overarching changes in NASA's processes for accounting for property were under development, including incorporation of new requirements to track government-furnished property and realignment of NASA coding structures in a manner that may facilitate developing estimates of planned acquisition activity, tracking such activity through the procurement cycle and recording property acquisition as the disbursements are made. Pending implementation of such overarching solutions, further emphasis on internal and external processes at headquarters, the centers, and the contractor locations is needed to ensure that amounts reported in its financial statements are reliable.

During our FY 2005 testing, we continued to note evidence of significant weaknesses in the property area. The weaknesses we noted during FY 2005, most of which are consistent with last year's audit report, fundamentally flow from not determining at the point of budget formulation, obligation recognition, contract development, accounts payable recognition, or disbursement the amounts of property NASA expects to buy, has contracted for, or has purchased. Rather, NASA waits until the entire transaction cycle is complete to obtain disbursement data for capitalization or, in the case of contractors, expects their contractors to do so. Insufficient internal controls

surrounding contractor-held PP&E, materials, and NASA-held theme assets, NASA-held work in progress (WIP), and NASA-held real and personal property are addressed below:

Contractor-Held Property:

The reliance upon NASA's contractors to report property values at periodic intervals during the year without robust agency-wide controls to ensure the reliability and validity of those property values may increase the probability of errors and deficiencies not being detected by NASA or reported by contractors. As noted in the prior year report and found during our FY 2005 audit work, the OCFO's utilization of the Defense Contract Audit Agency (DCAA) as its primary quality assurance mechanism over NASA's contractors has in fact uncovered errors in contractor amounts reported, which in turn provided management visibility to evaluate and assess the impact on the 2005 year-end financial statements. However, DCAA's role and the procedures that it performs cannot be relied upon by NASA management alone to ensure the reliability and validity of contractor-held property values. For instance, as noted in one FY 2005 DCAA Agreed Upon Procedures (AUP) Report, a \$553 million overstatement of WIP was discovered by the contractor in January 2004 (FY 2004), but was not reported by the contractor as an "adjustment" in its subsequent quarterly reports. Because DCAA uses these quarterly reports as a basis for its procedures, it was not discovered in the prior year AUP. Accordingly, DCAA only became aware of it during its FY 2005 procedures. Furthermore, the adjustment was reported by the contractor in its annual Form 1018 ("Property in the Custody of Contractors") filing, but not in time for recording into the FY 2004 financial statements.

Management has made progress during FY 2005 in this regard as noted below, but until management develops a robust framework of internal controls within NASA, these initiatives will not fully address the weaknesses related to contractor-held property:

- In FY 2005, the coverage period for the DCAA procedures was expanded to the performance of procedures on the June 30, 2005 property values. However, there were no other procedures performed during the last quarter to test for any significant or unusual activity. It is therefore, recommended that management consider incorporating analytical and inquiry procedures for the fourth quarter for DCAA to perform while conducting its more extensive agreed upon procedures on the June 30, 2005 balances.
- Certain major contractors are required to report and "certify" their property values on a monthly basis via the Web-enabled Contractor-Held Asset Tracking System (CHATS). Currently, each contractor has one assigned person to report and certify the accuracy of the reported balances in CHATS. We recommend that management consider further emphasis on the contractor's ability to detect and correct errors by creating a second-level certification requirement in CHATS for each contractor. Furthermore, several contractors are reliant upon their subcontractors to provide the property values to the contractor for inclusion in the contractor's report as part of the monthly reporting process. It would be incumbent upon the



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contractors to require a similar certification from their subcontractors or perhaps upon NASA to consider requiring specific contractor certification of subcontractor balances in the requirements. One alternative might also be for specific subcontractors to also utilize CHATS and self certify.

- Management issued Procurement Information Circular 05-07 effective October 1, 2005 to address certain documentation requirements for government-furnished (GF) property matters, such as the transfer of GF property to contractors and between contractors, which were discussed in the FY 2004 audit report. Specifically, it requires Contracting Officers to continually update and track all GF property and acquisition values maintained by a contractor throughout the life of the contract. This would require modification to the list to include any property furnished after the award of the contract.

NASA-Held Theme Assets Operational and WIP:

Beginning in FY 2004 and continuing throughout FY 2005, NASA has undertaken a project to review its policies (both accounting and procedural) with respect to theme assets (previously referred to as assets in space) to identify the specific types of costs that should be capitalized and those that should be expensed. These policies incorporated financial and engineering authoritative guidance as well as NASA program/project management policy to ensure consistent application and documentation. As one aspect of addressing the accounting issue over which costs are expensed versus capitalized for theme assets in progress and those yet to be undertaken, management during FY 2005 revised the engineering authoritative guidance contained in NASA Procedural Requirement 7120.5C, *NASA Program and Project Management Processes and Requirements*. This requirement defines the four management requirements for formulating, approving, implementing, and evaluating NASA programs and projects.

We were informed that effective October 1, 2005, the Project Management Information Improvement (PMII) initiative was implemented within the Core Financial Module in an attempt to provide better project management information to aid in decision-making. PMII implemented an aligned budget structure and technical work breakdown structure (WBS) in the Core Financial Module to support the agency's Earned Value Management initiative.

The PMII initiative will implement the FY 2006 budget structure and provide a technical WBS in the Core Financial Module which NASA has stated is the first step toward improving project management information.

NASA has stated that some key benefits of PMII are that it:

- Improves NASA's accountability and enables full cost management.
- Aligns the agency's technical WBS with the finance coding structure.

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- Ensures data standardization and configuration management.
- Provide a consistent and standardized tool for project management reporting.
- Provides timely, consistent, and reliable information for management decisions.
- Allows program and project managers to view detailed costs and obligations associated with a project.

NASA capitalizes costs for theme assets based on subsequent reviews of expenses, which, as discussed earlier, creates weaknesses in NASA's ability to accurately capture and report such costs. NASA management has informed us that they believe PMII will aid in creating sufficient specificity in NASA purchasing activity to facilitate tracking and reporting of all types of property acquisition activity, including the subset of such activity related to theme assets as projects are initiated and disbursements are made.

In FY 2005, NASA revisited its process to account for theme assets and developed a number of approaches, most recently positing that it is possible that much theme asset activity is fundamentally research and development and that such costs should be expensed. This contrasts with earlier views that none or a small part of such activity constituted research and development, and is a significant potential change from prior approaches which led NASA to capitalize billions of dollars in such items. NASA management is currently exploring these issues, and hopes to resolve the accounting policy-related aspects of its theme asset accounting independent of potentially longer-term needs to develop appropriate systems to capture such costs (however ultimately categorized).

These initiatives seem to be moving NASA in the right direction for identification of the component parts of theme assets throughout its life cycle. However, it is unclear as of yet how the alignment and the specificity of the preestablished WBS elements will correlate to the accounting for these costs under authoritative literature.

NASA-Held Real and Personal Property:

During our FY 2005 testing, we noted transactions that were not recorded at the appropriate value based upon the final amount paid (i.e., "three-way match" was not performed), not recorded in the correct fiscal year, lacked evidence of written authorization, or lacked required supporting evidence (NASA forms) and adherence to internal control policies and procedures, such as timely reconciliations to the subsidiary ledgers at centers were not being consistently followed. NASA management is reliant upon a monthly evaluation to determine which assets should be capitalized to record these transactions and maintains separate subsidiary ledgers which are not interfaced directly with the Core Financial Module. Accordingly, management needs to place additional emphasis to strengthen and enforce these center-specific manual



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prevent and detect controls as these are the baseline controls upon which NASA is reliant until the end-to-end process is put into place as previously mentioned.

Recommendation

We recommend that NASA continue to focus on resolving prior year issues and completing its implementation of suggested recommendations and developing detailed corrective action plans. In addition, we once again place further emphasis on recommending that NASA fundamentally revisit its approach to capitalizing property by documenting, analyzing, and implementing robust control changes from end to end to all categories of PP&E. We also recommend that all NASA obligation documents and expenditures be coded to identify whether they relate to a property acquisition to create a control for comparison to recorded property transactions and subsidiary ledgers, be they NASA activities or contractors.

REPORTABLE CONDITION

Internal Controls in Estimating NASA's Environmental Liability Require Enhancement

During our review of NASA's environmental liability estimates totaling \$825 million as of September 30, 2005, and related disclosures to the financial statements, we continued to note weaknesses in NASA's ability to generate an auditable estimate of its unfunded environmental liabilities (UEL) and to identify related potential financial statement disclosure items because of a lack of sufficient, auditable evidence.

In response to the issues first identified in our FY 2004 Report on Internal Control, NASA has developed a workplan to correct the weaknesses noted. However, while some limited progress has been made, we noted during the FY 2005 audit that NASA has not made sufficient progress in resolving the issues. For example:

- During our FY 2004 audit, we noted that the roles and responsibilities for the estimation of the UEL among NASA's Accounting, Environmental and Legal functional group were not sufficiently defined and implemented to ensure appropriate integration and input into the process. We also noted that NASA's accounting function deferred to the environmental functional group in preparation of the estimates, resulting in environmental professionals interpreting accounting requirements. During the FY 2005 audit, we noted that there was limited evidence of sufficient involvement from the OCFO in preparing the UEL estimate.
- During our FY 2004 audit, we noted that NASA personnel and its contractors had not received sufficient policies, procedures, and training in the process for estimating

environmental liabilities. In June 2005, NASA conducted a training session for all center and facility personnel involved in the UEL estimation process. Based on our fieldwork conducted after this training, NASA personnel require additional guidance and training in the estimation of the UEL.

- Consistent with our FY 2004 findings, NASA did not have adequate, auditable documentation to support its FY 2005 UEL estimates.
- Consistent with our FY 2004 findings, we noted during our audit that NASA continues to lack documented quality control or quality assurance procedures to ensure the accuracy of the UEL estimates. However, NASA has made progress in this area by implementing a new advocacy process at headquarters to assist the centers and facilities in the review of the UEL. The OCFO's participation in quality control of the UEL estimates will be necessary to resolve this issue.

Roles and Responsibilities Need Further Refinement

During our testing of the UEL estimates in FY 2004, we were informed that NASA's environmental professionals prepared the estimates without direction or oversight from the OCFO. Specifically, we were advised that the OCFO deferred to NASA's Environmental Management Division (EMD) as experts in the preparation of the estimates. As a result of this division of responsibility, NASA's EMD made interpretations of Federal accounting requirements in isolation without input and oversight from the OCFO.

During our testing of the UEL estimates in FY 2005, we still noted limited involvement from the OCFO. As indicated earlier, the OCFO codeveloped, in conjunction with EMD, a workplan to address resolution of prior year findings. This workplan contains an action item to conduct more detailed accounting training. As of the end of our fieldwork, the accounting training had not yet been completed. The limited accounting training that was conducted for the centers and facilities prior to the start of the FY 2005 UEL estimation process was presented by NASA's EMD.

In addition, a representative from the OCFO attended our review of the estimates at the centers and facilities we visited during our audit. However, there was no evidence that the OCFO or center accounting staff provided input or guidance into the preparation of the UEL estimates prior to our visit and review.

Further, NASA indicated in its workplan to address FY 2004 UEL audit observations, the OCFO and NASA legal representatives intend to meet with Department of Justice personnel on the third-party claims. The objective of the meeting, which is still pending as of the end of fieldwork, is to discuss a basis that would allow recognition of these liabilities in a time frame consistent with financial reporting requirements.



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Increased Guidance and Training Required

The preparation of NASA's UEL estimates requires an understanding of environmental cost estimating and related accounting guidance. During the FY 2004 audit, NASA indicated that its remedial project managers lacked sufficient environmental cost estimating experience to adequately prepare the estimates. To mitigate this deficiency, NASA began implementing the use of the Integrated Data Evaluation and Analysis Library (IDEAL) cost estimating software in FY 2004. IDEAL generates estimates through the use of parametric cost models. In FY 2005, NASA personnel received training on the use of the IDEAL model, which was used to prepare the FY 2005 estimates at all centers and facilities we visited. However, based on our review, the users still did not have a sufficient understanding of how the IDEAL system worked. This was evidenced by their questions about the software.

The limited accounting training that NASA's environmental personnel received during 2005 was provided by the EMD staff. This included estimating liabilities in accordance with the accounting guidance on "probable" and "reasonably estimable." However, the EMD training provided on estimating liabilities associated with the closure of hazardous waste storage tanks may be inconsistent with SFFAS No. 6, *Accounting for Property, Plant, and Equipment*, which requires the recognition of probable and measurable liabilities when the asset is placed in service. NASA EMD is developing the accounting treatment of storage tank closure but indicated it has decided to recognize the liability for the closure of tanks only when it becomes known that NASA intends to take a tank out of service.

Limited guidance was provided on the quantification, categorization, and tracking of changes in the UEL from year to year. As such, several NASA UEL estimators directly responsible for creating and updating the center/facility UEL estimates could not explain all differences for changes in their own center/facility UEL estimates from FY 2004 to FY 2005. NASA has indicated it will address this issue going forward by requiring UEL estimators to capture and document the reason for all UEL changes greater than \$200,000.

NASA communicated to us its awareness of the need to quantify and disclose "possible" UELs for financial statement purposes and its intention to develop and deliver procedures or guidelines to identify and evaluate possible liabilities for FY 2006 forward.

Documentation to Support Liability Need Improvements – Auditable Estimates

Consistent with FY 2004, the UEL estimate presented at the time of the audit was a draft estimate. No finalized UEL estimate was available for the FY 2005 audit. NASA is aware of the need to generate a finalized UEL estimate for the audit and has changed its timeline going forward so that an estimate will be generated in March, with adjustments being made in September. This timeline change is scheduled for FY 2006.

Insufficient Quality Control over Center Estimates

During the FY 2004 audit, we could not find evidence that NASA performed an independent quality review of the UEL estimates prepared by the centers and facilities. During FY 2005, we noted that “advocates” had been named and were responsible for performing quality control over the estimates. However, because the estimates were still in draft form during our visits, it was not evident what level of review had been performed. For example, at our Jet Propulsion Lab (JPL) visit, we noted that estimates that were initially represented as final were reclassified as draft when errors were detected during our review. In addition, as previously noted, while a representative from the OCFO observed our reviews of the center UELs, it was not evident that anyone from the OCFO had performed any sort of independent review prior to our audit.

As we identified in the FY 2004 audit, we believe it is important that the IDEAL model be periodically reconciled with actual spending to validate the model. Currently, IDEAL has not been validated and accredited for estimating NASA remediation scenarios in accordance with OMB and NASA guidelines. NASA indicated that some models within IDEAL were evaluated under a Department of Defense (DOD) contract. However, a review by the DOD’s OIG indicated similar concerns regarding validation of the model. NASA has, however, requested that the Office of Quality Assurance validate the IDEAL model.

NASA continues to exclude the internal labor costs for personnel who are wholly dedicated to the extinguishment of environmental remediation liabilities from the UEL. We believe this exclusion of labor costs is inconsistent with the full cost accounting principles adopted by NASA.

Recommendation

We recommend that NASA expedite the progress on the action plan it developed in response to our FY 2004 audit. In addition, we recommend that NASA include in the action plan the center and facility specific findings that were identified during the FY 2004 audit as opposed to the current workplan steps which address only those FY 2004 observations that were thought to be common across all centers or apply to headquarters. We also recommend that NASA’s OCFO perform a self-assessment of the UEL estimation and aggregation process. This assessment should focus on identifying additional weaknesses in NASA’s UEL system that went undetected because no final estimates were available for our review at the time of our audit.

NASA should also continue to validate the tools (including IDEAL) and methodology used at the center and facility level to prepare the UEL estimates.



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OTHER MATTERS

Summary of FY 2004 Material Weaknesses and Reportable Conditions

Issue Area	Summary Control Issue	FY 2005 Status
Material Weaknesses		
Financial Systems, Analyses, and Oversight	Documentation regarding significant accounting events, recording of non-routine transactions, and post-closing adjustments, as well as corrections and other adjustments made in connection with data conversion issues, must be strengthened. Processes to prepare financial statements need improvement.	Modified Repeat Condition
Further Research Required to Resolve Fund Balance with Treasury Differences	Supporting documentation to support application of rigorous reconciliation processes was not available. Unreconciled differences were identified in the FY 2003 year-end reconciliations.	Modified Repeat Condition
Enhancements Needed for Controls over Property, Plant, and Equipment and Materials	Controls relating principally to contractor-held PP&E and materials and NASA-held assets in space and WIP need improvement; headquarters oversight needs improvement.	Modified Repeat Condition
Improvements in the IFMP Control Environment are Needed	IFMP security design and implementation needs improvement; IFMP security and general IT controls need to be strengthened; oversight function supporting IFMP security program needs improvement; segregation of duties issues.	Substantially completed; segments related to segregation of duties and other access issues, combined with Financial Systems, Analyses, and Oversight weakness
Reportable Condition:		
Internal Controls in Estimating NASA's UEL Require Enhancement	Weaknesses noted in NASA's ability to generate auditable UEL estimates and to identify disclosure items; training of personnel; defined roles and responsibilities of OCFO and EMD staff.	Modified Repeat Condition

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In addition, with respect to NASA's internal control over Required Supplementary Stewardship Information and performance measures reported in the Management's Discussion and Analysis, we were unable to apply certain procedures prescribed by OMB Bulletin No. 01-02, because of the limitations on the scope of the audit of the financial statements, as discussed in our Report of Independent Auditors, dated November 4, 2005. Further, we did not audit and do not express an opinion on such controls.

We also noted certain other matters involving internal control that we will report to NASA management in a separate letter dated November 4, 2005.

This report is intended solely for the information and use of the management and the OIG of NASA, OMB, and Congress and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 4, 2005
Washington, D.C.



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Report on Compliance with Laws and Regulations

To the Administrator and the Office of Inspector General
of the National Aeronautics and Space Administration

We were engaged to audit the financial statements of the National Aeronautics and Space Administration (NASA) as of and for the year ended September 30, 2005, and have issued our report thereon dated November 4, 2005. The report states that because of the matters discussed therein, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the consolidated balance sheet as of September 30, 2005, and the related consolidated statements of net cost, changes in net position and financing and combined statement of budgetary resources for the fiscal year then ended.

The management of NASA is responsible for complying with laws and regulations applicable to NASA. We performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, including the requirements referred to in the Federal Financial Management Improvement Act of 1996 (FFMIA). We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to NASA.

The results of our tests disclosed one instance of potential noncompliance with the laws and regulations discussed in the preceding paragraph, exclusive of FFMIA, that is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 01-02. Based on a referral from OMB, NASA's management and the Office of Inspector General of NASA are currently evaluating whether NASA has violated certain provisions of the Anti-Deficiency Act (P.L. 101-508 and OMB Circular A-11). We have been advised that the review, which is in its initial stages, relates principally to whether obligations have been incurred in excess of apportioned funds for certain funds appropriated in prior years which, if properly and timely apportioned, are available for execution in subsequent years.

Under FFMIA, we are required to report whether NASA's financial management systems substantially comply with federal financial management systems requirements, applicable federal accounting standards, and the United States Standard General Ledger (SGL) at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA Section 803(a) requirements. However, as noted above, we were unable to complete our audit. Based upon the results of the tests we were able to complete, we noted certain instances, described below, in which NASA's financial management systems did not substantially comply with certain requirements:

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Report on Compliance with Laws and Regulations

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- The NASA accounting system lacks integration and does not conform to the requirements currently specified by the former Joint Financial Management Improvement Program. NASA's management continues to identify data integrity and configuration issues in the Core Financial Module, which results in inappropriate transactional postings. Additionally, NASA has been unable to provide detailed listings of balances from the Core Financial Module to support NASA's September 30, 2005 reported balances for accounts receivable, accounts payable, and undelivered orders. Finally, certain subsidiary systems, including property, are not integrated with the Core Financial Module.
- Issues with the Core Financial Module continue to hinder NASA's ability to identify and resolve certain issues with its fund balance with Treasury amounts.
- Data within NASA's financial system have not been validated as reliable and may not be reliable to support NASA's financial statements.
- Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities*, SFFAS No. 4, *Managerial Cost Accounting Concepts & Standards*, and NASA's Financial Management Requirements require costs to be accrued in the period in which they are incurred and any corresponding liability to be recorded as an account payable, regardless of the associated amounts obligated. However, NASA has designed its new Core Financial Module to include a system edit whereby if costs (and the corresponding liabilities) are greater than the associated obligations, the difference is not recorded in NASA's general ledger until further research is performed. Instead, these differences are stored outside of its general ledger until additional funds are obligated and the excess costs (and the corresponding liabilities) can be recorded. Similarly, the Core Financial Module will not allow negative costs or downward adjustments to be recorded in the general ledger. We believe that NASA's accounting treatment of costs in excess of obligations and downward adjustments during fiscal year 2005 represents noncompliance with the federal accounting standards requirements and SGL requirements under FFMIA.

The Report on Internal Control and management letter include information related to the financial management systems that were found not to comply with the requirements, relevant facts pertaining to the noncompliance, and our recommendations related to the specific issues presented. It is our understanding that NASA's management agrees with the facts as presented and that relevant comments from NASA's management responsible for addressing the noncompliance are provided as an attachment to this report.

Because we could not complete our audit, we were unable to determine whether there were other instances of noncompliance with laws and regulations that are required to be reported.



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Report on Compliance with Laws and Regulations
Page 3 of 3

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

This report is intended solely for the information and use of management and the Office of Inspector General of NASA, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Ernst + Young LLP

November 4, 2005
Washington, D.C.

National Aeronautics and
Space Administration
Headquarters
Washington, DC 20546-0001



November 14, 2005

Reply to Attn of:

The Office of the Chief Financial Officer

TO: Inspector General

FROM: Chief Financial Officer

SUBJECT: Management Response to Audit Report of Independent Auditors

We appreciate the efforts of the Office of Inspector General working with their contractor, Ernst & Young, LLP, to audit NASA's FY 2005 and 2004 financial statements. We understand that due to internal control challenges and residual system conversion matters, you were not able to express an opinion on the FY 2005 and 2004 consolidated balance sheet, and the related consolidated statements of net costs, changes in net position and financing, and combined statements of budgetary resources.

Your audit report identified three material weaknesses – Financial Systems, Analyses, and Oversight; Fund Balance with Treasury; and, Property, Plant, and Equipment. The material weaknesses are the result of inadequate internal controls and the remnants of NASA's conversion to a single Agencywide core financial management system. Our efforts to migrate to a new core financial system were designed to streamline NASA's financial management operations and management systems. The audit has exposed some unrealized process inefficiencies and shortcomings in the previous NASA Center based systems that continue to impact our current financial management improvements. Overcoming these issues is taking time, but we have a plan to remedy these issues.

Moving forward, the Office of the Chief Financial Officer is committed to making significant improvements in NASA's overall financial management. My staff and I look forward to working with you, your staff and Ernst & Young during the year to significantly improve our FY 2006 financial statement audit results.

Again, I appreciate your support.

Best,

A handwritten signature in black ink, appearing to read "Gwendolyn Sykes".

Gwendolyn Sykes